Jurisdictional Statement

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81-228

No.

In the Supreme Court of the United States

OCTOBER TERM, 1980

UNITED STATES OF AMERICA, ET AL.,
APPELLANTS

v.

GRACE BRETHREN CHURCH, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. Whether the Tax Injunction Act deprived the district court of jurisdiction over this action.

2. Whether the Federal Unemployment Tax Act constitutionally requires that participating state unemployment compensation programs cover employees of elementary and secondary schools that have a religious orientation, but are not controlled by a church or convention or association of churches.*

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* The parties in the court below were (App. E, *infra*, 39a-41a n.4):

Plaintiffs:

Grace Brethren Church of Long Beach, California, and its pastor, Rev. David L. Hocking;

Calvary Cross Church of the Highlands of San Bruno, California, and its pastor, Rev. Donald B. Sheley;

Scott Memorial Baptist Church of San Diego, California, and its pastor, Rev. Tim LaHaye;

Christian Unified Schools of San Diego, an incorporated association of five fundamentalist schools with a central office in El Cajon, California;

Redwood Christian Schools, an incorporated association of four fundamentalist schools with a central office in Castro Valley, California;

Sidney and Patricia Bowen of Compton, California, whose children attend Grace Christian Schools, an affiliate of plaintiff Grace Brethren Church;

Peter and Sue Farrelly of Pacifica, California, whose children attend Highlands Academy, an affiliate of plaintiff Calvary Cross Church of the Highlands;

William and Janet Tschantz of La Mesa, California, whose children attend plaintiff Christian Unified Schools of San Diego;

Arthur and Cheryl Brandwood of Hayward, California, whose children attend plaintiff Redwood Christian Schools;

Stanley Eddington of San Lorenzo, California, a teacher at plaintiff Redwood Christian Schools;
R. Florence Murti of Daly City, California, a teacher at Highlands Academy; and
R. Suzanne Royer of Long Beach, California, a teacher at Grace Christian Schools.

Defendants:

The State of California;
The California Employment Development Department;
The Director of the California Employment Development Department;
The United States of America;
The United States Department of Labor; and
The United States Secretary of Labor.

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the district court holding the Federal Unemployment Tax Act to be unconstitutional (App. E, *infra*, 38a-86a) is unreported. The original (App. A, *infra*, 1a-22a) and supplemental (App. C, *infra*, 25a-34a) opinions of the district court at the preliminary injunction stage are likewise unreported.

JURISDICTION

The judgment of the district court was entered on April 6, 1981 (App. F, *infra*, 87a-90a). The federal parties filed a notice of appeal to this Court on April 29, 1981 (App. G, *infra*, 91a-92a). On June 19, 1981, Justice Rehnquist extended the time in which to

docket an appeal to and including August 3, 1981 (App. H, *infra*, 93a). The jurisdiction of this Court is invoked under 28 U.S.C. 1252.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The First Amendment to the United States Constitution provides in pertinent part:

> Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof * * *.

26 U.S.C. 3309(b) provides in pertinent part:

> This section shall not apply to service performed—
>
> > (1) in the employ of (A) a church or convention or association of churches, or (B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches;

28 U.S.C. 1341 provides:

> The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

Cal. Unemp. Ins. Code § 634.5 (West Supp. 1980) provides in pertinent part:

> With respect to * * * any nonprofit organization described by Section 608, "employment" does not include * * * service performed in any of the following:
>
> (a) In the employ of (1) a church or convention or association of churches or (2) an organi-

zation which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches.

STATEMENT

This litigation was initiated by a number of California churches and religiously oriented schools to challenge the coverage of their school employees under the federal-state unemployment compensation system. Appellees contended that employees of the private schools they operated were excluded from the system under the terms of the Federal Unemployment Tax Act ("FUTA"), 26 U.S.C. (& Supp. III) 3301 *et seq.*, and the corresponding state law, the California Unemployment Insurance Code.[1] In the alternative, appellees argued that if their school employees were covered, such coverage violated the Religion Clauses of the First Amendment. In the district court appellants argued, *inter alia*, that the Tax Injunction Act, 28 U.S.C. 1341, barred the court from granting the relief requested and that, as to the merits, appellees' school employees were covered under the applicable law, and such coverage was constitutional. In a series of opinions, the court first determined that it had jurisdiction (App. A, *infra*, 16a-21a). The court then held that private schools that were either part of the corporate structure of a church (Category I schools) or directly affiliated with a church (Category II schools) were excluded from the unemployment compensation system under 26 U.S.C. 3309(b)(1) (App. A, *infra*, 9a-10a; App. E, *infra*, 41a). Finally, the court concluded that religiously

[1] The operation of the federal-state unemployment system is explained in *St. Martin Evangelical Lutheran Church* v. *South Dakota*, No. 80-120 (May 26, 1981), slip op. 1-2.

oriented schools that were not controlled by a church or convention or association of churches (Category III schools) were not excluded under the terms of the statute (App. E, *infra*, 41a-54a), but that coverage of such schools would result in excessive governmental entanglement with religion in violation of the Establishment Clause (*id.* at 66a-76a).[2]

Shortly after the court's final opinion below, this Court announced its decision in *St. Martin Evangelical Lutheran Church* v. *South Dakota*, No. 80-120 (May 26, 1981). In that case the Court held that schools that have no legal identity separate from a church are exempt from the federal-state unemployment compensation system under 26 U.S.C. 3309(b)(1)(A). This was essentially the same conclusion the district court in this case reached as to Category I schools. There were no Category II type schools before this Court in *St. Martin*, and hence the Court did not reach the question of coverage of such schools. Slip op. 10 n.12. Moreover, this Court in *St. Martin* noted that its statutory ruling in that case "makes it unnecessary for us to consider the First Amendment issues raised by petitioners" (slip op. 16).

THE QUESTIONS ARE SUBSTANTIAL

The district court has declared unconstitutional part of the congressionally devised system to protect the Nation's workforce from the economic rigors of unemployment.[3] The court erred in concluding that

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[2] Although this case was consolidated with *Lutheran Church-Missouri Synod* v. *California Employment Development Department*, No. CV 79-162 MRP, for decision below, only the instant case involves Category III schools (App. C, *infra*, 28a-29a).

[3] Although the judgment below in terms holds only the state analogue of the federal statute unconstitutional (App.

the application of those protections to employees of elementary and secondary schools that have a religious orientation, but are not controlled by a church or convention or association of churches, results in state entanglement with religion in violation of the First Amendment.[4] In light of the substantial, legitimate interests served by 26 U.S.C. 3309(b), this

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F, *infra*, 89a), that conclusion is based on an analysis of the identical federal statute (App. E, *infra*, 66a-74a). See *St. Martin Evangelical Lutheran Church* v. *South Dakota*, *supra*, slip op. 1-6. The court recognized that the federal statute provides for coverage of the affected employees, but held that that provision cannot constitutionally be implemented. Thus here, as in *United States* v. *Raines*, 362 U.S. 17, 20 (1960), and *McLucas* v. *DeChamplain*, 421 U.S. 21, 31 (1975), "it is clear that 'the basis of the decision below in fact was that the Act of Congress was unconstitutional.' " The state defendants below have also appealed to this Court from the judgment below (No. 81-31, filed July 8, 1981).

[4] A representative of a national association of fundamentalist schools testified that 20% of the member schools were not church-controlled (Tr. 120). The record contains no other indication of how many schools may be affected by the issue presented in this case.

A study prepared for the National Center for Education Statistics indicates that in the 1978-1979 school year there were 19,663 private schools in the United States, employing 272,664 teachers (R. Nehrt, *Private Schools in American Education* 15, Table A (1981)). Of these, 3,944 schools, employing 63,232 teachers, were not affiliated with any particular religious denomination (*id.* at 17, Table D). The study does not show how many of the nonaffiliated schools have a religious orientation, and it is not clear that the study's definition of "affiliation" corresponds precisely to the classifications contained in 26 U.S.C. 3309(b). See R. Nehrt, *supra*, at 39. It has been suggested that the number of fundamentalist schools is increasing at a rapid rate (Rice, *Conscientious Objection to Public Education: The Grievance and the Remedies*, 1978 B.Y.U. L. Rev. 847 n.3).

Court should note probable jurisdiction to review the district court's exercise of "the grave power of annulling an Act of Congress." *United States* v. *Gainey*, 380 U.S. 63, 65 (1965).[5]

1. Although we urge the Court to reach the merits (see pages 9-10, *infra*), we must point out that the district court erred in determining that it had jurisdiction of this suit.[6] The court below struck down one part of the federal-state unemployment compensation system. As this Court explained in *St. Martin Evangelical Lutheran Church* v. *South Dakota*, *supra*, slip op. 1-2, FUTA imposes an unemployment insurance tax on most employers, but offers a tax credit of up to 90% of that federal tax for employers who are taxed under a state unemployment insurance law that meets federal standards. 26 U.S.C. (& Supp. III) 3301-3302. While FUTA does not impose the federal tax on nonprofit employers, it does require participating states to levy a state

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[5] We do not ask this Court to review the district court's conclusions concerning the applicability of the statutory exemptions to Category I and Category II schools. The decision that Category I schools are exempted from FUTA is clearly correct under *St. Martin Evangelical Lutheran Church* v. *South Dakota*, *supra*. After careful consideration of the relevant legislation, the Secretary of Labor has concluded that Congress intended to treat Category I and Category II schools alike, and thus does not wish to challenge the conclusion that Category II schools are also exempt under the statutory scheme. We accordingly do not ask this Court to review the *Lutheran Church* case, which involves only Category I and Category II schools (see note 2, *supra*).

[6] The fact that the court below did not have jurisdiction does not affect the direct appealability of this action since "this Court's jurisdiction under § 1252 in no way depends on whether the district court had jurisdiction." *McLucas* v. *DeChamplain*, *supra*, 421 U.S. at 31.

tax on such employers. Thus, while the court below has concluded that both federal and state laws are unconstitutional, the actual tax that it enjoined was a state tax. Such action was beyond the jurisdiction of the district court under the Tax Injunction Act, 28 U.S.C. 1341.[7]

Federal courts have historically been especially reluctant to interfere with the collection of state taxes. *Tully* v. *Griffin, Inc.*, 429 U.S. 68 (1976). This reluctance was long ago codified in the Tax Injunction Act, 28 U.S.C. 1341, which provides that:

> The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

In the present case appellees had a plain, speedy and efficient remedy in California's courts. Therefore the federal district court was without jurisdiction to grant injunctive relief in this matter.

Under the Tax Injunction Act, the requirement that a litigant have a plain, speedy and efficient remedy under state law simply means that the state

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[7] Although the Tax Injunction Act does not in precise terms deprive the federal district courts of jurisdiction to enter a declaratory judgment that a state tax is unconstitutional, this Court has recognized that "its underlying policy * * * require[s] that federal courts stay completely out of the field of anticipatory adjudication of tax cases so long as an adequate remedy is otherwise available." *Perez* v. *Ledesma*, 401 U.S. 82, 127 (1971) (Brennan, J., concurring in part and dissenting in part). See *Great Lakes Dredge & Dock Co.* v. *Huffman*, 319 U.S. 293, 299 (1943). Accord, *Aluminum Co. of America* v. *Dept. of the Treasury of Michigan*, 522 F.2d 1120, 1123 (6th Cir. 1975); *28 East Jackson Enterprises, Inc.* v. *Culberton*, 523 F.2d 439, 440 n.2 (7th Cir. 1975), cert. denied, 423 U.S. 1073 (1976).

courts must offer him an "adequate" remedy. *Garrett* v. *Bamford*, 538 F. 2d 63, 67 (3d Cir.), cert. denied, 429 U.S. 977 (1976); *Ford Motor Credit Co.* v. *Louisiana Tax Commission*, 440 F. 2d 675, 676 (5th Cir. 1971); C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure: Jurisdiction* § 4237 (1978). Moreover, for a state remedy to be adequate under the Tax Injunction Act it need not be the best remedy available, or even equal to or better than the remedy that might otherwise be available in the federal courts. *Mandel* v. *Hutchinson*, 494 F. 2d 364, 367 (9th Cir. 1974); *Bland* v. *McHann*, 463 F. 2d 21, 29 (5th Cir. 1972), cert. denied, 410 U.S. 966 (1973).

Appellees' state remedy met this standard. Before resorting to the courts, a California employer may administratively appeal any determination of employer liability. After an employer's administrative remedies are exhausted, it can file a state court action to recover contributions that were wrongfully collected. Cal. Unemp. Ins. Code § 1241 (West Supp. 1980).[8] If an employer is unsuccessful in its state court action, it may appeal through the California court system to the state Supreme Court. From there a litigant can, of course, seek final review in this Court. 28 U.S.C. 1257. The remedy available to appellees in California's courts is thus similar to that invoked in the state courts of South Dakota in the *St. Martin* case, *supra*, and is entirely adequate for purposes of the Tax Injunction Act.[9] This being the

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[8] If an employer prevails in such an action it will be awarded interest on the money it was wrongfully required to pay to the state. Cal. Unemp. Ins. Code § 1242 (West Supp. 1980).

[9] This procedure for obtaining a refund of unemployment insurance taxes is analogous to other California tax refund procedures, which the Ninth Circuit has ruled to be "plain,

case, the district court erred in holding there was no adequate remedy available in the California judicial system. Because of the adequacy of the state court remedy available in California, the Tax Injunction Act deprived the district court of jurisdiction over this matter.[10]

For the above reasons, we submit that the district court should have dismissed this action. Because it did not do so, but instead concluded that the identical provisions of the state and federal statutes were unconstitutional, it raised doubts about the continuing

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speedy and efficient" for purposes of the Tax Injunction Act. *Mandel* v. *Hutchinson*, *supra*, 494 F.2d at 367; *Aronoff* v. *Franchise Tax Board*, 348 F.2d 9 (9th Cir. 1965); *Harsh California Corp.* v. *County of San Bernardino*, 262 F.2d 626, 628, 630 (9th Cir. 1958). Additionally, in a suit precisely analogous to the instant one, brought by a religious organization against federal and state officials to challenge its coverage under FUTA, the United States District Court for the Eastern District of California has specifically ruled that the remedy available in California's courts in such actions is sufficient for purposes of the Tax Injunction Act and accordingly that that Act divests federal courts of jurisdiction over such challenges. *Stockton Metropolitan Ministry* v. *Glick*, Civ. No. S-80-807 MLS (E.D. Cal. Apr. 16, 1981).

[10] The district court found the Tax Injunction Act inapplicable because appellees contend that "the collection procedure itself violates the constitution" (App. C, *infra*, 20a n.14); it accordingly concluded that the return of any unconstitutionally collected taxes would not make the appellees whole (*id.* at 18a). The court relied heavily on *Gray* v. *Morgan*, 371 F.2d 172 (7th Cir. 1966), cert. denied, 386 U.S. 1033 (1967), as supporting its analysis. But in *Huber Pontiac, Inc.* v. *Whitler*, 585 F.2d 817, 818-819 (7th Cir. 1978), the Seventh Circuit disavowed that limitation of the scope of the Tax Injunction Act as inconsistent with this Court's reaffirmation of the Act's jurisdictional bar in *Lynch* v. *Household Finance Corp.*, 405 U.S. 538, 542-543 n.6 (1972).

applicability of 26 U.S.C. 3309(b) that would not be resolved if this Court were to decide this appeal on purely jurisdictional grounds. Moreover, the Secretary's interpretation of that statute and of this Court's decision in *St. Martin Evangelical Lutheran Church* v. *South Dakota*, *supra*, is being challenged in a number of other suits. In light of the public interest in, and the Secretary's need for, a definitive interpretation of 26 U.S.C. 3309(b), and because the Tax Injunction Act does not by its express terms bar the issuance of a declaratory judgment (see note 7, *supra*), it would be appropriate for this Court to conclude that special circumstances justify its consideration of the merits of the district court's issuance of the declaratory judgment against the federal defendants. We urge the Court to reach the merits on this aspect of the relief. Cf. *McLucas* v. *DeChamplain*, *supra*, 421 U.S. at 31-32.

2. On the merits, the court below held that unemployment coverage of employees of Category III schools was mandated by FUTA,[11] but that such coverage would result in excessive church-state entanglement in violation of the Establishment Clause of the First Amendment. The Establishment Clause is violated by the enactment of a law that establishes a religion or takes a step that could lead to such establishment. *Lemon* v. *Kurtzman*, 403 U.S. 602, 612 (1971); *Engel* v. *Vitale*, 370 U.S. 421, 430 (1962). This Court has recognized a three-pronged analysis where a statute raises an Establishment Clause question. A statute "does not contravene the Establishment Clause if it has a secular legislative

[11] The court correctly found that the evidence submitted to show that the Category III schools here involved are "churches" within the meaning of the Section 3309(b)(1) exemption was "extremely weak" and of "little probative value" (App. E, *infra*, 42a, 43a).

purpose, if its principal or primary effect neither advances nor inhibits religion, and if it does not foster excessive government entanglement with religion." *Committee for Public Education and Religious Liberty* v. *Regan*, 444 U.S. 646, 653 (1980). The court below held that the third requirement is violated here.

At the outset, we note that there may be some conceptual confusion in the district court's reliance on the Establishment Clause. This Court has stated that, although the Establishment Clause and the Free Exercise Clause of the First Amendment may at times overlap, "they forbid two quite different types of governmental encroachment upon religious freedom." *Engel* v. *Vitale*, *supra*, 370 U.S. at 430. Decisions of this Court that have applied the Establishment Clause in overturning legislation because of excessive entanglement, or upholding legislation against an entanglement objection, have involved laws that *aided* religion or religious organizations. See, *e.g.*, *Committee for Public Education and Religious Liberty* v. *Nyquist*, 413 U.S. 756 (1973) (school aid); *Lemon* v. *Kurtzman*, 403 U.S. 602 (1971) (school aid); *Walz* v. *Tax Commission*, 397 U.S. 664 (1970) (tax exemption); *Epperson* v. *Arkansas*, 393 U.S. 97 (1968) (anti-evolution law). Here, however, the entire thrust of appellees' argument below was that FUTA coverage of employees of religiously oriented schools hinders, rather than assists, the exercise of religion. Such a claim, in our view, would lie principally, if not exclusively, under the Free Exercise Clause.[12] However, as will be shown below, even

[12] The district court specifically concluded, after detailed analysis, that application of the federal-state unemployment compensation scheme to employees of religiously oriented schools did not violate the Free Exercise Clause. App. E, *infra*, 56a-66a.

if Establishment Clause analysis were appropriate here or entanglement considerations were equally applicable to a Free Exercise claim, FUTA does not foster an excessive entanglement with religion.

This Court has frequently emphasized that some contacts between church and state are inevitable. The dispositive question—whether those contacts are excessive—is one of degree. See *Lemon* v. *Kurtzman*, *supra*, 403 U.S. at 614; *Walz* v. *Tax Commission*, *supra*, 397 U.S. at 674. Here, the only church-state contacts necessarily resulting from coverage of Category III schools arise from the requirement that such schools register as employers with the California Employment Development Department ("EDD"), keep accurate employment records, make related reports to the EDD, and make certain employment information available to their employees. Cal. Unemp. Ins. Code §§ 1085 *et seq.* (West 1972 & Supp. 1980). The records and reports required of employers concern such innocuous matters as the hours worked by, and wages paid to, each employee; the date each employee was hired and separated from employment; and the total number of employees and wages paid in each calendar quarter. This type of routine recordkeeping does not significantly entangle church and state. In fact, the recordkeeping involved here is more routine and less extensive than the recordkeeping involved in the reimbursement process in *Committee for Public Education and Religious Liberty* v. *Regan*, *supra*, which this Court held not to constitute excessive entanglement. 444 U.S. at 659-661.

The court below, however, did not rely on what the federal-state unemployment laws actually require in striking them down. Rather, the court focused on consequences that allegedly will result from the pro-

cedures by which the state determines a former employee's eligibility for unemployment benefits. FUTA does not require—but does permit—participating states to deny or reduce unemployment benefits to persons who were discharged for misconduct connected with their work. 26 U.S.C. 3304(a)(10). Based on this provision, all 50 states, including California, deny or reduce benefits to any former employee who is dismissed for "misconduct connected with his most recent work." Cal. Unemp. Ins. Code § 1256 (West Supp. 1980). A former employer has a financial stake in such a determination because the fewer the benefits paid to former employees, the lower an employer's financial obligation to the state will be. The district court held that the misconduct determination will raise Establishment Clause problems in the case of employees of religiously oriented schools, because those employees may be dismissed for religiously motivated reasons. The court stated that in determining whether such a former school employee was dismissed for misconduct, making him ineligible for benefits, the state will be required to second-guess the school's determination in matters of religious doctrine or morality. Such essentially religious determinations by the state, the court concluded, violate the First Amendment.

The district court's analysis misperceives the nature of the state's inquiry in an eligibility determination. The Category III schools involved in this action serve persons who belong to a number of different Christian sects. While the religious beliefs of such persons no doubt differ on a number of issues, presumably on other issues they share certain religious beliefs. The state has no need to second-guess or overrule these religious beliefs. The state's concern

—in the case of a claimant who was discharged from his job—is a quite distinct question: whether the actions for which the claimant was discharged constituted "misconduct" under the legal standards of Cal. Unemp. Ins. Code § 1256.

The answer to that question has nothing to do with determining what is true doctrine or what is immoral conduct. Rather, the answer has to do with work rules. Teaching false doctrine is not, per se, misconduct under Cal. Unemp. Ins. Code § 1256. However, failure to abide by an established work rule is misconduct. Religiously oriented schools have it in their power to establish whatever work rules their religion requires (*e.g.*, a requirement that school teachers teach doctrinal matters as instructed by the school principal). The challenged laws impose no restrictions whatsoever on the establishment of such religiously motivated work rules. Once those rules are agreed to by such a school and its employees, a teacher discharged for violating such a rule will be guilty of misconduct under California law and therefore ineligible for benefits. However, this determination will not be because the state has decided what is true doctrine or what constitutes moral behavior; rather, it will be based on the state's determination that the former employee violated an agreed-upon work rule.

In short, the federal and state unemployment compensation laws in no way limit an employer's ability to establish whatever work rules it wishes and to require adherence to them as a condition of employment. School authorities may interpret their religious doctrines in whatever manner they wish, and establish corresponding work rules requiring adher-

ence to their interpretations.[13] Whether those interpretations accurately reflect that religious doctrine is quite beside the point. Deliberate refusal to abide by an established work rule would in any event constitute misconduct under Cal. Unemp. Ins. Code § 1256. Accordingly, there is no need for the state to second-guess a school's interpretation of its religion.[14]

The history of the federal-state program and the record in this case demonstrate that the entanglement feared by the district court is purely hypothetical. Coverage of religious organizations under the unemployment compensation system is not a new phenomenon. Colleges—including those with a religious orientation—have been covered since the Employment Security Amendments of 1970, Pub. L. No. 91-373, 84 Stat. 695. Similarly, employees of elementary and secondary schools—including those with a religious orientation—were first covered by the unemployment compensation system, from 1974 to 1978, under Title II of the Emergency Jobs and Unemployment Assistance Act of 1974, Pub. L. No. 93-567, 88 Stat. 1850. In most states all such elementary and secondary school employees were covered under the Secretary of Labor's interpretation

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[13] Contrary to the assumption of the district court (App. E, *infra*, 70a), these work rules need not themselves attempt to define accepted doctrinal positions; they may simply require the teacher to conform to the principal's interpretations of doctrinal matters.

[14] While a benefit eligibility determination does not require an inquiry into religious matters, even if such an inquiry were necessary, this Court has often recognized that some limited inquiry into religious matters may be necessary and permissible in the course of resolving purely secular legal issues. See *Wisconsin* v. *Yoder*, 406 U.S. 205, 215-216 (1972); *United States* v. *Ballard*, 322 U.S. 78 (1944).

of the Unemployment Compensation Amendments of 1976, Pub. L. No. 94-566, 90 Stat. 2667, from 1978 until this Court's recent rejection of that interpretation in *St. Martin Evangelical Lutheran Church* v. *South Dakota, supra.* Outside of the educational context, other religiously oriented organizations not directly controlled by a church or convention or association of churches have been covered since the Employment Security Amendments of 1970.

Notwithstanding this history of coverage, plaintiffs below presented no evidence that they or any other religiously oriented organization had ever been involved in a single actual claim for unemployment benefits that required an inquiry into church doctrine. Thus, the decision below regarding entanglement is not based on the requirements of the law or the evidence in the record. It rests only on a misunderstanding of what a benefit eligibility determination requires and speculation as to what such a determination might entail.[15]

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[15] The district court noted, but found it unnecessary to consider, appellees' claim that refusal to exclude the unaffiliated religiously oriented schools from FUTA coverage would constitute a denial of equal protection in violation of the Fifth Amendment (App. E, *infra*, 74a-76a). This claim too is without merit, since there is a rational basis for distinguishing between Category I and Category II schools on the one hand, and Category III schools on the other. It is not unreasonable to conclude that independent schools, even if they assert a religious orientation, should be treated like secular schools rather than like the church-controlled schools that are entitled to the statutory exemption. The decision to treat these schools differently than church-run schools is justified on several grounds: First, church-run schools are more likely to have a strong religious orientation than inter-denominational schools or those established and run by the laity. Second, the risk of church-political entanglement is greater when church-con-

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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AUGUST 1981

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trolled schools are involved. Third, there is a greater likelihood that employees of church-controlled schools will be provided with non-governmental assistance for economic hardship caused by unemployment. Finally, the distinction is practical to administer; it is relatively easy to determine whether a particular school is church controlled, but it may be very difficult to determine whether it is sufficiently "religious" to qualify for exemption as a Category III school, and such a determination might involve a substantial risk of government intrusion into a constitutionally sensitive area.

Appendix

APPENDIX A

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Case No. CV 79-93 MRP

GRACE BRETHREN CHURCH and
REVEREND DAVID L. HOCKING, ETC., ET AL.,
PLAINTIFFS

v.

STATE OF CALIFORNIA, ETC., ET AL., DEFENDANTS

Case No. CV 79-162 MRP

THE LUTHERAN CHURCH—MISSOURI SYNOD, a non-profit membership corporation on behalf of 85 member Luthern Churches, ETC., ET AL., PLAINTIFFS

v.

THE STATE OF CALIFORNIA EMPLOYMENT
DEVELOPMENT DEPARTMENT, ET AL., DEFENDANTS

OPINION

At the height of the depression of the 1930's, unemployment in the nation exceeded 25% of the work force. In an attempt to alleviate some of the resulting hardships, Congress enacted Title IX of the Social Security Act of 1935 (herein "the Act"), Pub. L. No. 94-271, 49 Stat. 620, the forerunner of the Federal Unemployment Tax Act (herein "FUTA") (now codified at 26 U.S.C. §§ 3301-3311). Employers with eight or more employees were made subject to an excise tax computed as a percentage of wages payable for services performed in "employment" as

defined in the Act. 49 Stat. 635. The employer was, however, entitled to a credit against his federal tax liability for up to 90% of any contributions to a fund established under a federally approved state unemployment compensation law. 49 Stat. 639-640. In addition, Congress provided in Title III of the Social Security Act (codified at 42 U.S.C. §§ 502-504) for federal grants to the states to pay for costs incurred in administering the state unemployment compensation laws. 49 Stat. 626. Given this incentive, all states enacted such laws, which, in order to meet the requirements for federal approval,[1] essentially paralleled the coverage of FUTA.[2]

The federal unemployment tax provisions remained substantially unchanged for two decades after enactment.[3] Then in the mid-1950's, a steady expansion of unemployment insurance coverage commenced. For example, in 1954 Congress extended the tax liability to employers with four or more employees and enacted an unemployment compensation program for federal employees.[4] In 1958, an unemployment compensation program was enacted for Armed Services employees.[5]

In 1970, § 3304(a)(6)(A) was added to FUTA requiring the states to extend unemployment insurance coverage to employees of non-profit organiza-

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[1] 26 U.S.C. § 3304(a) contains the specific requirements for approval of a state unemployment insurance program.

[2] *See, e.g., Cal. Unempl. Ins. Code* §§ 1-15000 (West 1972).

[3] In 1939, FUTA was made a part of the Internal Revenue Code, 53 Stat. 1, 183.

[4] *See* Pub. L. No. 767, 68 Stat. 1130.

[5] *See* Pub. L. No. 85-848, 72 Stat. 1087, 1088.

tions,[4] effective January 1, 1972. Subparagraph (b) of the new § 3309 permitted the states to exclude from coverage those employees performing, *inter alia*, services:

> (1) in the employ of (A) a church or convention or association of churches, or (B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches;
>
> (2) by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order;
>
> (3) in the employ of a school which is not an institution of higher education.

In response to these amendments, the State of California (herein "the State"), extended coverage under the California Unemployment Insurance Code to services performed for non-profit organizations with the exception of those specified in § 3309(b).

Effective January 1, 1978, Congress amended § 3309 by deleting Subsection (b)(3) which permitted exemption of services performed by individuals "in the employ of a school which is not an institution of higher education." Effective the same date, California amended § 634.5(c) of its Unemployment Insurance Code to maintain consistency with the federal law.

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[4] *See* the Employment Security Amendments Act, Pub. L. No. 91-373, 84 Stat. 695. Pursuant to 26 U.S.C. §§ 3301 & 3306(c) (1976), nonprofit organizations are exempt from paying *federal* unemployment insurance tax, even though the federal government requires the state's programs to cover such organizations.

This case arises out of the Secretary of Labor's (herein "the Secretary") interpretation of the 1978 amendment to § 3309(b) as requiring extension of unemployment compensation coverage to employees of primary and secondary religious schools, exempting only those individuals who perform "strictly church duties" during more than half of their working time.[7]

I

THE ISSUES PRESENTED

The plaintiffs in these two cases are religious organizations which operate private elementary and secondary schools. In No. 79-0162 (the "Lutheran" case), plaintiff is a "Synod" consisting of 85 member churches which operate private schools. The Lutheran case was originally brought in the Superior Court of the State of California against the Employment Development Department of the State of California (herein the "EDD"); Martin Glick, its Director; and the Secretary. The case was removed to this court by the Secretary pursuant to 28 U.S.C. §§ 1441 and 1442. Case No. 79-0093 (the "Grace Brethren" case) was originally brought in this court against these same parties. The State has cross-claimed against the Secretary in both cases.

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[7] 26 U.S.C. § 3306(d) specifies that "if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment." Subsection (c)(8) of that section excludes from the definition of employment "service performed in the employ of a religious, charitable, educational, or other organization described in section 501(c)(3) which is exempt from income tax under section 501(a)."

Both groups of plaintiffs seek a preliminary injunction against the defendants enjoining collection of the unemployment tax with respect to their employees. The Secretary moves for dismissal on the ground that plaintiffs lack standing and that the court lacks jurisdiction to grant the injunctive relief requested by plaintiffs. The Secretary also moves to dismiss the State's cross-claim for declaratory relief on the ground that the State has failed to exhaust administrative remedies. The following discussion will constitute the Findings of Fact and Conclusions of Law in both cases and will apply to both applications for a preliminary injunction as well as to the pending motions.

II

DISCUSSION

A. Standing to Sue the Secretary of Labor

The Secretary argues that since the State's participation in the federal program is voluntary, plaintiffs lack standing to sue him in the present action. It is the Secretary's position that since it is the State which is causing plaintiffs' alleged damage, both cases must be dismissed as to him.

In order for a plaintiff to have standing under Article III, he must establish that "the asserted injury was the consequence of the defendants' actions, or that prospective relief will remove the harm." *Simon* v. *Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26, 45 (1976). However, this does not mean that a plaintiff may not sue a governmental defendant who has caused him indirect rather than direct harm. "When a governmental prohibition or restriction imposed on one party causes specific harm

to a third party, harm that a constitutional provision or statute was intended to prevent, the indirectness of the injury does not necessarily deprive the person harmed of standing to vindicate his rights." *Warth* v. *Seldin*, 422 U.S. 490, 505 (1975); *Gladstone Realtors* v. *Village of Bellwood*, No. 77-1493 (Sup. Ct. April 17, 1979). However, it does make it "substantially more difficult to meet the minimum requirement of Art. III: to establish that, in fact, the asserted injury was the consequence of the defendants' actions, or that prospective relief will remove the harm" *Warth*, 422 U.S. at 505. The injury may be indirect, *see United States* v. *SCRAP*, 412 U.S. 669, 688 (1973), but it must be "fairly traceable to the defendants' acts or omissions." *Arlington Heights* v. *Metropolitan Housing Corp.*, 429 U.S. 252, 261 (1977).

In the present case, the State has for many years maintained an unemployment compensation program upon which a large number of employees depend. If California should fail to remain in accord with FUTA regulations, it risks decertification of its program and the substantial hardship to California employers and employees which would result from termination of its FUTA benefits. Thus, while initial participation in FUTA is voluntary, once a state has established an unemployment compensation program, it is compelled to conform its program to FUTA regulations as they may be amended from time to time.

The fact that the states are under compulsion to adopt the Secretary's interpretation of the modification of § 3309(b) is evidenced by the directive from the U.S. Department of Labor to "All State Employment Security Agencies" from Lawrence W. Rogers, Administrator of Field Operations (herein "the Di-

rective"). The Directive states that "Secretary Marshall's decision concerning unemployment insurance coverage of services performed for church-related schools . . . was clearly intended to result in State coverage of church-related elementary and secondary schools." The Secretary's interpretation was not merely advisory. On the contrary, the Secretary was fully justified in expecting total compliance by the states.

As further evidence that the Secretary's actions are indeed the cause of the injury to plaintiffs, the State has cross-claimed against the Secretary requesting the court to counter the Directive. In that cross-claim, the State alleges that it interprets § 3309 (b) differently from the Secretary, and that it agrees with plaintiffs' contention that employees of church schools should be exempt. The State further alleges that:

> pursuant to sections 3304(a)(6), 3304(c) and 3309 of the Federal Act, cross-claimants must substantially comply, and are now complying, with the Secretary's interpretation as to which services under such section 3309 must be covered by California for unemployment insurance, and which services may be permissibly excluded by California from unemployment insurance coverage.

Under these circumstances the position that the harm alleged by plaintiffs is the consequence of the State's actions and not those of the Secretary is wholly unrealistic.[8]

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[8] On January 18, 1979, Judge Leroy J. Contie of the United States District Court, Northern District of Ohio, issued a memorandum opinion denying standing to sue the Secretary of Labor in a case virtually identical to the present one. *St.*

B. Propriety of Injunctive Relief

The standard for granting injunctive relief in the Ninth Circuit was set forth in *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 526 F.2d 86, 88 (9th Cir. 1975) quoting from *Charlie's Girls, Inc.* v. *Revlon, Inc.*, 483 F.2d 953, 954 (2d Cir. 1973):

> One moving for a preliminary injunction assumes the burden of demonstrating *either* a combination of probable success and the possibility

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John Lutheran Church, Inc. v. *Giles*, 78-1516 (N.D. Ohio, filed January 18, 1979). The opinion stated:

> [t]he Secretary has no power to compel the state to comply with the requirements for certification. An order against the Secretary could not redress the plaintiff's alleged injury because the Secretary has no power to change the state laws of which plaintiff complains. Therefore the plaintiff has no standing to assert a claim against the Secretary, and the Secretary must be dismissed from the action.

Memorandum Opinion at 2-3.

Judge Contie's restrictive analysis of the standing requirements seems contrary to that of the Supreme Court in *Super Tire Engineering Co.* v. *McCorkle*, 416 U.S. 115 (1974). There the Court found Article III standing on the basis that the State of New Jersey adversely affected the interests of employers engaged in collective bargaining by offering public assistance to striking workers. Clearly New Jersey could not, by providing or withholding assistance, force or restrain employees from engaging in strike activity. Nevertheless, the Court held there was standing since New Jersey's policy "by its continuing and brooding presence, [cast] what may well be a substantial adverse effect on the interests of the petitioning parties." *Id.* at 122. Here, although the Secretary cannot directly alter state law, the "brooding presence" of possible decertification is capable of constraining state compliance, with substantially adverse effects on the plaintiffs.

> of irreparable injury *or* that serious questions are raised and the balance of hardships tips sharply in his favor. [Emphasis original.]

Plaintiffs have met not only the second, more flexible test for granting preliminary injunctive relief, but the first, more stringent test as well.

1. Likelihood of Success on the Merits

a. *Meaning of Statute*

As stated above, the Secretary interpreted the 1976 amendment of § 3309 as eliminating the heretofore accepted exclusion for employees of primary and secondary schools operated by churches. However, § 3309 (b)(1) exempts those "in the employ of (A) a church . . . or (B) an organization which is operated primarily for religious purposes and which is operated . . . by a church." The employees in these cases clearly appear to fall within category 1(A) of this Section. However, the Secretary appears to argue that they are not entitled to exemption under § 3309 because they fail to meet the additional requirements of Subsection 1(B) in that the religious schools are not, in his view, operated "primarily for religious purposes."

The simple answer to the Secretary's argument is that the two subsections are disjunctive and compliance with Subsection 1(A) above is sufficient to warrant exemption. The legislative history of § 3309 tends to support the view that religious schools such as the ones here in question which are not separately incorporated, need not meet the standards of Subsection 1(B) in order to insure exempt status.

> This paragraph excludes services of persons where the employer is a church or convention or association of churches, but does not exclude cer-

> tain services performed for an organization which may be religious in orientation unless it is operated primarily for religious purposes and is operated, supervised, controlled, or principally supported by a church (or convention or association of churches). *Thus, the services of the janitor of a church would be excluded but services of a janitor for a separately incorporated college, although it may be church related, would be covered.* A college devoted primarily to preparing students for the ministry would be exempt, as would a novitiate or a house of study training candidates to become members of religious orders. On the other hand, a church related (*separately incorporated*) charitable organization (such as, for example, an orphanage or a home for the aged) would not be considered under this paragraph to be operated primarily for religious purposes.

H.R. Rep. No. 612, 91st Cong., 1st Sess. 44 (1969) [Emphasis added].

This quote indicates that Congress intended the tax to be applicable to the services of employees of *separately incorporated* organizations, but not to church operations run directly by the church with its own employees. Thus, it is reasonable to infer that Congress did not intend to include church schools within the scope of unemployment compensation.

b. *Unconstitutional Entanglement*

It is well established that a statute should, if possible, be construed to avoid constitutional infirmities. *See, e.g., United States* v. *Vuitch*, 402 U.S. 62, 70 (1971). The Secretary argues that his interpretation of § 3309(b) does not violate the establishment clause of the First Amendment because taxing a church

could in no way be considered "establishment" of religion. Further, there could be no violation of the free exercise clause because although the tax might put some financial burden on the free enterprise of religion (*e.g.*, inhibiting a church from firing an employee on religious grounds for fear of having to pay unemployment compensation), this burden is minimal and not *per se* unconstitutional.

However, as stated in *Walz* v. *Tax Commission*, 397 U.S. 664, 674 (1970):

> [d]etermining that the legislative purpose . . . is not aimed at establishing, sponsoring, or supporting religion does not end the inquiry, however. We must also be sure that the end result—the effect—is not an excessive government entanglement with religion.

Excessive government entanglement, in and of itself, will result in a violation of the constitutional protections against establishment *and* the inhibition of free exercise.[9] *See Lemon* v. *Kurtzman*, 403 U.S. 602, 612 (1971); *NLRB* v. *Catholic Bishop*, 47 U.S.L.W. 4283 at 4287 (March 20, 1979).

The entanglement resulting from the Secretary's interpretation stems from the requirement that with respect to these church schools, the states must deter-

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[9] Although much of the law relating to excessive entanglement is in the context of government support to religious schools, the Supreme Court has made it clear that "[t]he hazards of churches supporting government are hardly less in their potential than the hazards of government supporting churches; each relationship carries some involvement rather than the desired insulation and separation." [Footnote omitted.] *Walz*, 397 U.S. at 675. *See also Catholic Bishop*, 47 U.S.L.W. at 4286-87.

mine who is subject to the unemployment compensation tax and who is not. In the Directive, states are advised that:

> [i]f an employee performs both non-exempt and exempt services during a single employment period, as in the case of services performed for a church-related school and an organization exempted by section 3309(b)(1), and "if the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employees [sic] for such period shall be deemed to be employment, but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment," as provided in Section 3306(d), FUTA.

Thus, the State is required to make the determination whether, during any given pay period, an employee has spent more than one-half of his time on purely religious activities. If so, that employee is exempt.

The potential for excessive entanglement in making these decisions is manifest. That religious teaching permeates the curriculum of private religious schools has been clearly acknowledge by the Supreme Court of the United States:

> The analysis of the constitutional objections to these two state systems of grants to parochial or sectarian schools must start with the admitted and obvious fact that the *raison d'etre* of parochial schools is the propagation of a religious faith.

Lemon, 403 U.S. at 628 (Douglas J. concurring.)

Based on its recognition of this permeation, the Court in *Lemon* found the provision of economic support to be a potential violation of the establishment clause, even when such support was restricted to supplementing salaries of teachers of purely secular subjects. It is clear that in cases such as *Lemon*, the concern is not only that some of the supported teachers might in fact teach religious doctrine, but more significantly, that entanglement between church and state will necessarily occur when steps are taken to insure that teachers do not engage in religious teaching.

In this case, as in *Lemon*, the inquiry necessarily involved in policing the application of the exemption, "puts a public investigator into every classroom and entails a pervasive monitoring of these church agencies by the secular authorities." *Lemon*, supra at 627 (Douglas J., concurring). Yet without such monitoring, there would be no way of making the determinations required by the Secretary's interpretation of § 3309. As stated in *Catholic Bishop* "[i]t is not only the conclusions that may be reached . . . which may impinge on rights guaranteed by the Religion Clauses, but the very process of inquiry leading to findings and conclusions." 47 U.S.L.W. at 4286-87.

The religious schools in this case argue that all of their courses of study are designed to advance their religious principles. Thus, in order to enforce the tax, it will be necessary for the EDD to determine as to each employee whether their activities are "purely religious" more than one-half of the time. That controversies will arise, for example, as to whether in a world history class the teacher spends more than one-half of any given session teaching

purely "religious" or purely "secular" history can hardly be subject to doubt.[10] And disputes unquestionably will arise in situations where employees are dismissed for cause and the reason given by the church school is failure to adhere to religious tenets of the church.

The type of inquiry necessary to the resolution of controveries such as these is almost identical to that which the Court found to involve dangers of excessive entanglement in *Catholic Bishop*. There, the question was whether a particular action was an unfair labor practice. The resolution of such a charge "in many instances, [would] necessarily involve inquiry into the good faith of the position asserted by the clergy-administrators and its relationship to the school's religious mission." 47 U.S.L.W. at 4286. Such an inquiry, taken by itself, involves impermissible entanglement of the state with the church, violative of the separation of those entities mandated by the Constitution.

2. Possible Irreparable Injury

Plaintiffs have met their burden of showing that they are likely to suffer irreparable injury if an injunction is not issued against collection of the unemployment compensation tax. Plaintiffs have submitted a number of affidavits showing that inquiries into the religious content of a teacher's activities have

[10] Plaintiffs, of course, argue that such a determination is impossible to make since they teach all subjects, including history, from a religious perspective. While some events in history may be less amenable to such an approach, e.g., the Civil War, it would seem that much Middle Eastern and European history might well be taught differently if viewed from a strictly religious perspective.

already been made by the EDD. For example, on February 27, 1979, the Pilgrim Lutheran Church was required by the EDD to answer a series of questions with respect to thirty-six employees on the church's payroll ledger. Among these questions were the following:

> "What services were performed by each individual?
>
> "Where were the services performed?"
>
> "If performed for both the school and church, what was the percentage for each?

The church was also asked to identify any "licensed, ordained or commissioned minister(s) among the employees"; to describe the procedure necessary to become a minister; to specify whether the services performed by a minister constitute "the conduct of religious worship or the ministration of sacerdotal functions"; and to state whether the services are "performed pursuant to an assignment or designation by his ecclesiastical superiors." Such inquiry is far more intrusive than that directed to Monsignor O'Donnell which is attached as an appendix to *Catholic Bishop* for the purpose of illustrating how entanglement can result from the "very process of inquiry." The declarations here are replete with examples of inquiry by the State auditors into the religious qualifications of the teachers employed, the content of the subjects taught, and the extent to which the teachers are involved in activities other than teaching. Clearly the unconstitutional entanglement which, even in situations where it is only po-

tential, can invalidate a statute, is occurring on a regular basis at the present time.[11]

It has been held that the deprivation of fundamental constitutional rights constitutes irreparable injury. *Lewis* v. *Kugler*, 446 F.2d 1343, 1350 (3d Cir. 1971); *Schnell* v. *City of Chicago*, 407 F.2d 1084, 1086 (7th Cir. 1969); *Green* v. *Kennedy*, 309 F. Supp. 1127, 1139 (D.D.C. 1970), *appeal dismissed* 398 U.S. 956 (1970); *Fortune Society* v. *McGinnis*, 319 F. Supp. 901, 903 (S.D.N.Y. 1970). In particular, a violation of the establishment clause has been the basis of the issuance of an injunction. *Public Funds for Public Schools* v. *Marburger*, 358 F. Supp. 29 (D.N.J. 1973), *aff'd*, 417 U.S. 961 (1974). Here, plaintiffs have shown not only potential, but actual violation of the Religion Clauses.

3. Jurisdiction to Grant Relief Requested

The Secretary has argued that even if there were a constitutional violation in the enforcement of § 3309 as interpreted, this court lacks subject matter jurisdiction to grant either injunctive or declaratory re-

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[11] One declaration details the visit of an auditor to a preschool. The auditor, after asking detailed questions as to what transpired in the music class, the "nature center" and the "block center," ended by classfying music as strictly religious and the nature and block centers as both religious and secular. There is even a list of exempt employees which was given to one of the church schools at the conclusion of an audit. Among those listed was the church custodian "that % that applies to church (if % is greater for school than 100% salary is taxable)." One wonders how the auditor will determine the percentage of the custodian's time spent on the church versus the church school since the same buildings are frequently used for both purposes.

lief. The Secretary relies on 28 U.S.C. § 1341 which provides:

> The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a *plain, speedy and efficient remedy may be had in the courts of such State.* [Emphasis added]

As concluded above, the facts of this case justify the issuance of an injunction to prevent the collection of the unemployment tax. However, it appears that this remedy is not available in the state court. Article XIII, section 32 of the Constitution of the State of California provides:

> No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax.

Similarly, California's Unemployment Insurance Code § 1851 provides:

> No injunction or writ of mandate or other legal or equitable process shall issue in any suit, action or proceeding, in any court against this State or against any officer thereof to prevent or enjoin the collection of any contribution sought to be collected under this division.

Thus, the availability of injunctive relief in State court is, at best, uncertain.[12]

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[12] There is some California authority for the proposition that the anti-injunction statute and the constitutional mandate may have some exceptions where a challenge is made to a tax law on the ground that it is unconstitutional. *See, e.g.*, *McKay Jewelers, Inc.* v. *Bowron*, 19 Cal. 2d 595, 122 P.2d

However, the Secretary correctly points out that the state remedy need not be as effective as the federal remedy, so long as it is plain, speedy and efficient. *Mandel* v. *Hutchinson*, 494 F.2d 364, 367 (9th Cir. 1974). The Secretary maintains that the declaratory remedies available in state court or the administrative remedies which might be available to plaintiffs are adequate, even if plaintiffs are required to pay the tax and later sue for refund. *See Great Lakes Dredge & Dock Co.* v. *Huffman*, 319 U.S. 293 (1943); *Matthews* v. *Rogers*, 284 U.S. 521, (1932). This is true even when a constitutional violation is alleged. *King* v. *Sloane*, 545 F.2d 7, 8 (6th Cir. 1976); *Mandel*, 494 F.2d at 366-367; *Bland* v. *McHann*, 463 F.2d 21 (5th Cir. 1972), *cert. denied* 410 U.S. 966 (1973); *Helmsley* v. *City of Detroit*, 320 F.2d 476, 478-79 (6th Cir. 1963).

However, the present case is distinguishable from those cited above. Plaintiffs here claim not merely that the tax unconstitutionally deprives them of their property, as was the claim in all of these cases; rather, plaintiffs are claiming that the very process of determining whether any tax is due at all results in a violation of their First Amendment rights. Such violation cannot be remedied by a return of the tax paid if the statute is eventually found to be unconstitutional in state court.

The distinction between a deprivation of property rights as opposed to personal liberty as a basis for

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543 (1942); *Bueneman* v. *City of Santa Barbara*, 8 Cal. 2d 405, 65 P.2d 884 (1937); *Las Animas & San Joaquin Preciado*, 167 Cal. 580, 140 P.239 (1914). However, this authority is neither compelling nor recent. It is thus not established that plaintiffs would not be barred by the anti-injunction provisions cited should they seek an injunction in state court.

granting injunctive relief is discussed in *Gray* v. *Morgan*, 371 F.2d 172 (7th Cir. 1966), *cert. denied* 386 U.S. 1033 (1967). In that case, the court grappled with the problem of whether a claimed constitutional violation could in fact overcome "both the force of 28 U.S.C. § 1341 (as to federal injunctions against enforcement of state tax laws) and the reasons for federal restraint (as to federal declaratory judgments or judgments for tax refunds)." *Id.* at 174. The court concluded that if the alleged constitutional violation is of personal, rather than property rights, such a claim could prevail over the proscriptions of § 1341. *Id.* at 175.[13]

Even in a case where the harm to personal rights did not rise to the level of a First Amendment claim, it has been held that an injunction is appropriate where the process of collecting the tax would result in irreparable injury. In *United States Steel Corp.* v. *Multistate Tax Commission*, 367 F. Supp. 107 (S.D.N.Y. 1973), plaintiffs were required by a state taxing statute to turn over their books and records to persons whose authority and qualifications they claimed were invalid. The court granted an injunction against the collection of the state tax, rejecting

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[13] In holding that injunctive relief should not be granted, the court noted that "[i]n the instant case, we have no claim of the denial of procedural due process. Plaintiffs do not complain of the method of assessing or collecting the tax. They complain of the tax itself." These plaintiffs complain both of the tax *and* the process. The court relied heavily in its analysis on a scholarly district court opinion, *Abernathy* v. *Carpenter*, 208 F. Supp. 793 (W.D. Mo. 1962), *aff'd per curiam*, 373 U.S. 241 (1963), which contains an excellent discussion of the concerns relevant to the granting of such an injunction.

the proposition that the plaintiffs could pay the tax and sue for refund in state court. The court noted that this remedy had an infirmity since, "because it is unavailable to plaintiffs until after the audits have been conducted, it might cause plaintiffs irreparable injury. . . In cases where irreparable injury would occur if no injunction were to be granted, federal courts will entertain suit." *Id* at 116. As discussed above, a violation of the establishment clause constitutes irreparable injury, and this injury cannot be avoided without the issuance of an injunction against the collection of the tax.[14]

Furthermore, the granting of an injunction in this case would not be contrary to any of the policy considerations which underlie the anti-injunction statute. As stated in *Matthews* v. *Rodgers*, 284 U.S. 521 at 525 (1932):

> The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it.

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[14] In a recent district court case, *Independent Baptist Church* v. *State of Tennessee*, No. 1-78-194 (D. Tenn., filed Nov. 21, 1978), involving identical issues, the court dismissed the action on the basis that the plaintiff's state remedy of suing for refund was adequate, even though no injunction was available in state court. The opinion states that "[t]he situation of the plaintiffs . . . does not appear substantially different from the situation of any other individual contending that a tax is unconstitutional." *Id.* at 5. However, the court did not address itself to the point raised here, that the collection procedure itself violates the constitution. Presumably, this argument was not raised before that court.

Here, the concern over federalism is not compelling since an interpretation of a federal statute is being imposed by the Secretary upon the State. In fact, the State has represented that it disagrees with the Secretary's interpretation and has itself petitioned this court to resolve the present dispute. It is difficult to characterize the posture of the State in the present litigation as in any sense "independent." Thus, the injunction, if granted, would not interfere with the State's autonomy.

C. Motion to Dismiss Cross-Claim

The State has cross-claimed against the Secretary challenging the constitutionality of the Directive. However, the State has available to it an administrative remedy by which it can raise such a challenge. This administrative procedure is detailed in 26 U.S.C. 3304(c), 3310. Since the State has not exhausted its administrative remedies, its cross-claim against the Secretary must be dismissed. *See McKart* v. *United States*, 395 U.S. 185, 193 (1969); *Myers* v. *Bethlehem Shipbuilding Corp.*, 303 U.S. 36, 51 (1938).

III

CONCLUSION

The plaintiffs are entitled to a preliminary injunction against the State and the EDD to restrain collection of unemployment and disability tax[15] with respect to their employees. The Secretary has represented to this court that he will not decertify the State's program if the State is out of conformity due to an injunction issued by this court. Thus, no separate injunction is necessary as to him at this time.

The motion of the Secretary to be dismissed for lack of standing is denied, however, the Secretary's motion to dismiss the State's cross-claim is granted.

DATED: September 21, 1979

/s/ Mariana R. Pfaelzer
MARIANA R. PFAELZER
United States District Judge

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[15] Under *Cal. Unemp. Ins. Code* § 2606 (West 1972), covered services for disability insurance purposes are the same as covered services for unemployment insurance. The basis for granting injunctive relief against the collection of the disability tax is thus the same as for collection of the unemployment tax.

APPENDIX B

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Case No. CV 79-93 MRP

GRACE BRETHREN CHURCH and
REVEREND DAVID L. HOCKING, ETC., ET AL.,
PLAINTIFFS

v.

STATE OF CALIFORNIA, ETC., ET AL., DEFENDANTS

Case No. CV 79-162 MRP

THE LUTHERAN CHURCH—MISSOURI SYNOD, a non-profit membership corporation on behalf of 85 member Lutheran Churches, ETC., ET AL., PLAINTIFFS

v.

THE STATE OF CALIFORNIA EMPLOYMENT
DEVELOPMENT DEPARTMENT, ET AL., DEFENDANTS

Filed: Sept. 21, 1979

ORDER

Based on the Findings of Fact and Conclusions of Law contained in the Opinion filed concurrently herewith.

IT IS ORDERED that,

1. Defendant State of California (herein "the State") and defendant Martin Glick, Director of the Employment Development Department of the State of California and their agents, employees, representatives, and all persons acting under, in concert with

them or for them are hereby enjoined and restrained from attempting to collect from plaintiffs Grace Brethren Church and members of plaintiff The Lutheran Church-Missouri Synod unemployment insurance tax or disability tax or information relating to the collection of such taxes for or on account of those individuals who work at schools operated by said plaintiffs.

2. Plaintiff Grace Brethren Church shall post a bond in the amount of $1,000.00 and plaintiff Lutheran Church-Missouri Synod shall post a bond in the amount of $5,000.00.

3. The motion of the Secretary of Labor that he be dismissed as a defendant for lack of standing is denied.

4. The motion of the Secretary to dismiss the State's cross-claim for failure to exhaust administrative remedies is granted.

5. The Clerk of the Court shall serve a copy of this Judgment and the Opinion filed concurrently herewith on all of the parties to this section.

DATED: September 21, 1979.

/s/ Mariana R. Pfaelzer
MARIANA R. PFAELZER
United States District Judge

APPENDIX C

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Case No. CV 79-93 MRP

GRACE BRETHREN CHURCH and
REVEREND DAVID L. HOCKING, ETC., ET AL.,
PLAINTIFFS

v.

STATE OF CALIFORNIA, ETC., ET AL., DEFENDANTS

Case No. CV 79-162 MRP

THE LUTHERAN CHURCH—MISSOURI SYNOD, a non-profit membership corporation on behalf of 85 member Lutheran Churches, ETC., ET AL., PLAINTIFFS

v.

THE STATE OF CALIFORNIA EMPLOYMENT
DEVELOPMENT DEPARTMENT, ET AL., DEFENDANTS

Filed Jun. 2, 1980

SUPPLEMENTAL OPINION

The employees who perform services for the schools involved in these two cases fall into three categories:

Category 1: Those who are in the employ of a church or a convention or association of churches.

Category 2: Those who are in the employ of a separate corporation formed by a church

or a convention or association of churches.

Category 3: Those who are in the employ of a corporation which is operated primarily for religious purposes, but which is not operated, supervised, controlled or principally supported by a church or convention or association of churches, i.e., an independent, non-church affiliated religious school.

On September 21, 1979, the Court granted the preliminary injunction sought by plaintiffs in both cases as to employees in the first category described above. After the Order Granting the Preliminary Injunction was entered, a Motion for Clarification was filed by defendants State of California, Employment Development Department, and Martin Glick properly bringing to the Court's attention certain ambiguities in the opinion and questioning the reach of the preliminary injunction granted by the Court. At the hearing on the Motion for Clarification, the Court informed the parties that the preliminary injunction extended only to employees who performed services in schools which were not separately incorporated and who were therefore in the direct employ of a church or convention or association of churches. The Court then asked the parties to submit additional briefing on the issue of whether the injunction should be extended to cover the employees of the separately incorporated schools which are also the subject of these actions. That briefing having been completed, and the Court having heard argument on that issue, this opinion deals with the following remaining categories of employees:

Category 2: As stated above, this category includes those employees who are in the employ of a corporation formed by a church or a convention or association of churches. Corporations in this category operate the following schools:

> Cal Lutheran School, in San Diego, California, incorporated under the name of Center for Lutheran Education.
>
> Good Shepherd Lutheran School, in Simi Valley, California, incorporated under the name of Good Shepherd Lutheran School
>
> Los Angeles Lutheran High School, in Burbank, California, incorporated under the name of the Lutheran High School Association of Southern California
>
> Lutheran High School La Verne, in La Verne, California, incorporated under the name of Faith Lutheran High School Association.
>
> The Lutheran School of the Foothills, in La Crescenta, California, incorporated under the name of the Lutheran School of the Foothills, Inc.
>
> Lutheran High School of Orange County, in Orange, California, incorporated under the name of the Lutheran High School Association of Orange County
>
> Covenant Lutheran School, in Los Angeles, California, incorporated under the name of Covenant Lutheran School Corporation

It is clear that the employees of these schools could also be categorized as persons in the employ of an organization which is operated primarily for religious purposes and is operated, supervised, controlled

and principally supported by a church. Indeed, as pointed out at Page 8 of the Court's initial Opinion in this matter, the legislative history of 26 U.S.C. § 3309(b)(1) indicates that it was intended that a distinction be made between religious school personnel who are in the direct employ of a church or convention or association of churches and religious school personnel who are in the employ of a separate corporation formed by a church or convention or association of churches. From the legislative history, it would seem that if a church or convention or association of churches chooses to operate a school directly with the school personnel as its own employees, its employees are intended to fall within § 3309(b)(1)(A), but if the church or convention or association of churches chooses to separately incorporate a school, the employees must meet the requirements of § 3309(b)(1)(B) if they are to be exempt. Although there may be a rational basis for this distinction when applied to the employees of a school incorporated by *one* church, there seems to be no basis for such a distinction in the case of a school operated by a convention or association of churches. Unlike the case of a school operated by one church, it is clear that if a convention or association of churches desires to operate a *single* school, some legal entity would have to be formed for that purpose. Even though a corporate entity may be chosen in order to permit the churches to operate the school together, it is certainly arguable that the corporation's employees are actually in the employ of a convention or association of churches, and that the employees fall within § 3309(b)(1)(A).

Category 3: As stated above, this category includes those employees who are in the employ of a

corporation which is operated primarily for religious purposes, but which is not operated, supervised, controlled or principally supported by a church or a convention or association of churches. Corporations in this category operate the following independent, non-church affiliated religious schools:

> Redwood Christian Schools, a corporation which is a community of four schools, with a central office at Castro Valley, California
>
> Christian Unified Schools of San Diego, a corporation which is a community of eight schools, with a central office at El Cajon, California

Obviously, the categorization of the schools is merely a preliminary step in determining the propriety of injunctive relief, and the Court now turns to that principal issue.

With respect to Category 2 above, it is clear that the statements in the Court's prior Opinion regarding the plain meaning of the statute apply somewhat differently but with equal force to these schools as well as to those which are not separately incorporated. The first six listed in this category are schools whose employees logically fall within the plain meaning of 26 U.S.C. § 3309(b)(1)(A) in that they are in the employ of a convention or association of churches and, in each case, a substantial number of the churches involved are members of The Lutheran Church-Missouri Synod. In addition, it is manifest that the same serious constitutional objections to the Secretary of Labor's (herein "the Secretary") interpretation of the 1978 amendment of § 3309(b)(1) and the State's adoption of that interpretation with respect to § 634.5(a) of the California Unemployment Insurance Code exist with respect to these

schools as exist in the case of the schools in Category 1 above.

The last school listed in Category 2 is operated as a separate corporation by one church which is a member of the Synod. As discussed above, the legislative history of § 3309(b)(1) would seem to indicate that the employees of this school fall within § 3309(b)(1)(B) rather than § 3309(b)(1)(A). Indeed, although the Court in the above discussion has treated the employees of the first six schools as being within § 3309(b)(1)(A), the legislative history may well require that all of the employees in this category be classified within § 3309(b)(1)(B) because of their separate incorporation.

To allow the issue of the propriety of injunctive relief to turn on the question of whether the schools are or are not separately incorporated obviously permits form to override substance. Nevertheless, if separate incorporation does result in the employees of the separately incorporated schools being classified as within § 3309(b)(1)(B) rather than § 3309(b)(1)(A), the determination of their exemption from the tax is made more complex. If the employees are in the direct employ of a church or a convention or association of churches, the only inquiry which is necessary is whether in fact the employer is such an entity. If it is, under the plain meaning of § 3309(b)(1)(A) and its counterpart, § 634.5(a)(1) of the California Unemployment Insurance Code, the employees are exempt. However, if the employees fall within § 3309(b)(1)(B), or its counterpart, § 634.5(a)(2), the requirement that the school be operated "primarily for religious purposes" *and* be "supervised, controlled, or principally supported by a church or convention or association of churches" must be satisfied. Thus, the State has argued that

the burden is on the separately incorporated schools to furnish *some* information from which the State can determine that the school meets the statutory requirements of § 634.5(a)(2). There is no doubt that the State is correct in this contention as to schools which fall within § 634.5(a)(2), and it is also true that the determination of exemption as to these schools requires the State to engage in a more detailed inquiry than is required with respect to the employees of those schools which fall within § 634.5 (a)(1).

Although the State appears to be mainly concerned that it receive adequate information on which to base a determination of exemption, the Secretary's position is wholly different. His position is that employees performing services in church-related schools are covered regardless of whether the school is an integral part of the church or separately incorporated, and regardless of whether the employee performs services directly for a church or a separate corporation. Under the Secretary's interpretation, only employees performing strictly church duties at the schools pursuant to their church responsibilities are exempt and a determination of the exempt and non-exempt services must be made for each pay period. The Secretary's test for exemption is not based on the identity of the employer but on the nature of the services performed by the employee during each pay period. Under this interpretation, the State is required to engage in constant monitoring of the activities of the employees of these schools to make the determination of exemption for each pay period. As the Court stated in its original Opinion, this monitoring and surveillance of the activities of the teachers in these religious schools impermissibly entangles the State in religious activities.

In the opinion of the Court, whether the employees of the schools in this category fall within § 3309(b)(1)(A) or (B), or the State counterpart of those subsections, § 634.5(a)(1) or (2), the State should be able to make a determination of exemption without the constant monitoring required by the Secretary's interpretation. In fact, if information such as that which has been given to this Court is given to the State, and that information is appropriately verified, the employees of these schools should be exempt. Further monitoring and inquiry of the type required by the Secretary's interpretation raises the same problems of unconstitutional entanglement as to the employees of these schools as it does with respect to the employees in Category 1. Thus, the preliminary injunction should be extended to the employees of schools in Category 2 as well.

As to the employees of the schools in Category 3, plaintiffs in the Grace Brethren case argue that since these schools are substantially identical in religious purpose and orientation to those in the other two categories, the employees of these schools should be treated identically with respect to exemption from the unemployment and disability tax. The difficulty with that argument is that, even assuming as a matter of fact that substantial similarity exists between the schools in this category and those in the other two, the legal analysis of the question of exemption of the employees of these schools is entirely different. Obviously, these employees do not fall within the plain meaning of the statute. Indeed, they are not covered by the statute at all. Thus, the claim that the imposition of the tax is unconstitutional in the case of the employees of the Category 3 schools does not arise out of the Secretary's interpretation of the statute or the process of inquiry required by that interpre-

tation. Since no claim can be made that the statute covers these employees, it must be presumed that the Secretary would have no reason to question how their time is spent. Whatever the employees of these schools may teach or do, they could not be exempt under this statute and any inquiry by the Secretary would therefore be pointless.

Thus, plaintiffs' contention that since the Court has concluded that a danger of unconstitutional entanglement exists with respect to the employees in Categories 1 and 2, it must also reach that conclusion with respect to those in Category 3 must be rejected. The argument of unconstitutional entanglement is far less compelling in the case of these schools than in the case of the schools in Categories 1 and 2. In fact, there would appear to be little active involvement of the state in religious activities resulting from the imposition of the tax with respect to these employees. The imposition of the tax may well be wrong on other grounds, but it does not entail the degree of danger of excessive entanglement found in *NLRB* v. *Catholic Bishop*, 440 U.S. 490 (1979) and *Lemon* v. *Kurtzman*, 403 U.S. 602 (1971). Further, the Court does not find the argument that the Free Exercise Clause is violated by the imposition of the tax to be compelling at all. That argument will require further development at the time of trial, but the evidence heretofore presented in support of this argument has not been convincing.

Finally, it is urged that to treat the non-church religious schools differently from the church affiliated religious schools would violate the Equal Protection Clause of the Fourteenth Amendment. This Argument raises even more difficult questions than the other two and will also require additional briefing and development at the time of trial.

In sum, the Court finds merit in some of the arguments advanced by the plaintiffs in the Grace Brethren case regarding the schools in Category 3 but it does not find them sufficiently persuasive to require the extension of the injunction to the employees of these schools on the present state of the record.

The Court finds that as to the employees in Categories 1 and 2, plaintiffs in the two cases have satisfied both of the alternate tests for the propriety of injunctive relief set forth in *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 526 F.2d 86, 88 (9th Cir. 1975). With respect to the employees in Category 3, plaintiffs in the Grace Brethren case have satisfied neither of these tests, and even if the standards in *Inglis* are viewed as "merely extremes of a single continuum" (*Benda* v. *Grand Lodge of International Association of Machinists*, 584 F.2d 308, 315 (9th Cir. 1978)), these plaintiffs have not demonstrated the degree of probability of success on the merits or the existence of sufficiently serious questions required to warrant the issuance of an injunction. Further, they have not shown that the balance of hardships tips significantly in their favor.

In accordance with this Supplemental Opinion, which shall constitute further Findings of Fact and Conclusions of Law in both cases, the preliminary injunction is granted with respect to the employees of the schools in Categories 1 and 2 and denied with respect to the employees of the schools in Category 3.

DATED: June 2, 1980

/s/ Mariana R. Pfaelzer
MARIANA R. PFAELZER
United States District Judge

APPENDIX D

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Case No. CV 79-93 MRP

GRACE BRETHREN CHURCH and
REVEREND DAVID L. HOCKING, ETC., ET AL.,
PLAINTIFFS

v.

STATE OF CALIFORNIA, ETC., ET AL., DEFENDANTS

Case No. CV 79-162 MRP

THE LUTHERAN CHURCH—MISSOURI SYNOD, a non-profit membership corporation on behalf of 85 member Lutheran Churches, ETC., ET AL., PLAINTIFFS

v.

THE STATE OF CALIFORNIA EMPLOYMENT
DEVELOPMENT DEPARTMENT, ET AL., DEFENDANTS

Filed June 2, 1980

ORDER GRANTING
PRELIMINARY INJUNCTION

Based on the Findings of Fact and Conclusions of Law contained in the Supplemental Opinion filed concurrently herewith,

IT IS ORDERED that,

1. Defendant State of California (herein "the State") and defendant Martin Glick, Director of the

Employment Development Department of the State of California and their agents, employees, representatives, and all persons acting under, in concert with them or for them are hereby enjoined and restrained from collecting or attempting to collect unemployment insurance tax or disability tax or further information relating to the collection of such taxes for or on account of those individuals who work at the following schools:

Cal Lutheran High School, in San Diego, California, incorporated under the name of Center for Lutheran Education.

Good Shepherd Lutheran School, in Simi Valley, California, incorporated under the name of Good Shepherd Lutheran School

Los Angeles Lutheran High School, in Burbank, California, incorporated under the name of the Lutheran High School Association of Southern California

Lutheran High School La Verne, in La Verne, California, incorporated under the name of Faith Luthern High School Association

The Lutheran School of the Foothills, in La Crescenta, California, incorporated under the name of the Lutheran School of the Foothills, Inc.

Lutheran High School of Orange County, in Orange, California, incorporated under the name of the Lutheran High School Association of Orange County

Covenant Lutheran School, in Los Angeles, California, incorporated under the name of Covenant Lutheran School Corporation

2. Plaintiff Grace Brethren church has heretofore posted a bond in the amount of $1,000.00 and plaintiff Lutheran Church—Missouri Synod has heretofore posted a bond in the amount of $5,000.00. By stipulation of the parties to both actions, those bonds shall satisfy the requirement of security pursuant to Fed. R.Civ.P. 65(c).

3. The Clerk of the Court shall serve a copy of this Order and the Supplemental Opinion filed concurrently herewith on all of the parties to this action.

DATED: June 2, 1980

/s/ Mariana R. Pfaelzer
MARIANA R. PFAELZER
United States District Judge

APPENDIX E

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Case No. CV 79-93 MRP

GRACE BRETHREN CHURCH and
REVEREND DAVID L. HOCKING, ETC., ET AL.,
PLAINTIFFS

v.

STATE OF CALIFORNIA, ETC., ET AL., DEFENDANTS

Case No. CV 79-162 MRP

THE LUTHERAN CHURCH—MISSOURI SYNOD, a non-profit membership corporation on behalf of 85 member Lutheran Churches, ETC., ET AL., PLAINTIFFS

v.

THE STATE OF CALIFORNIA EMPLOYMENT
DEVELOPMENT DEPARTMENT, ET AL., DEFENDANTS

Entered April 6, 1981

Filed April 3, 1981

SECOND SUPPLEMENTAL OPINION

In an Opinion of September 21, 1979 and a Supplemental Opinion of June 2, 1980, this Court concluded that the Secretary's [1] proposed interpretation

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[1] The use of the abbreviations found in this Court's previous opinions will be continued in the course of this Opinion.

of 26 U.S.C. 3309(b), imposed on the states by his directive,[2] was both erroneous as a matter of statutory construction and inconsistent with the constitutional prohibition against excessive state entanglement with religion. None of the subsequent developments in these two cases have altered that conclusion and the Court now reaffirms it. Accordingly, this Court's previous discussions of the language and legislative history of § 3309(b) and of the constitutionally impermissible entanglement which results from the application of the Secretary's "strictly church duties" test of exemption from unemployment tax coverage will not be repeated but, rather, are incorporated herein by reference.

There are, however, a number of residual constitutional and statutory issues either expressly reserved in this Court's prior opinions [3] or only developed fully since those opinions were issued. These additional issues, as developed in the briefs and declarations submitted by the parties [4] and the evidence presented

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[2] The directive in question was Unemployment Insurance Program Letter No. 39-78 and was issued by Lawrence W. Rogers to all state employment security agencies on May 30, 1978. *See* this Court's Opinion of September 21, 1979, p. 6.

[3] *See, e.g.*, Supplemental Opinion (June 2, 1980), pp. 9-10.

[4] For convenience of reference, the parties in these two cases are set forth here.

GRACE BRETHREN, CV 79-93 MRP

The plaintiffs in this action are:

Grace Brethren Church of Long Beach, California, and its pastor, Rev. David L. Hocking;

Calvary Cross Church of the Highlands of San Bruno, California, and its pastor, Rev. Donald B. Sheley;

[Footnote continued on page 40a]

[4] [Contnued]

Scott Memorial Baptist Church of San Diego, California, and its pastor, Rev. Tim LaHaye;

Christian Unified Schools of San Diego, an incorporated association of five fundamentalist schools with a central office in El Cajon, California;

Redwood Christian Schools, an incorporated association of four fundamentalist schools with a central office in Castro Valley, California;

Sidney and Patricia Bowen of Compton, California, whose children attend Grace Christian Schools, an affiliate of plaintiff Grace Brethren Church;

Peter and Sue Farrelly of Pacifica, California, whose children attend Highlands Academy, an affiliate of plaintiff Calvary Cross Church of the Highlands;

William and Janet Tschantz of La Mesa, California, whose children attend plaintiff Christian Unified Schools of San Diego;

Arthur and Cheryl Brandwood of Hayward, California, whose children attend plaintiff Redwood Christian Schools;

Stanley Eddington of San Lorenzo, California, a teacher at plaintiff Redwood Christian Schools;

R. Florence Murti of Daly City, California, a teacher at Highlands Academy; and

R. Suzanne Royer of Long Beach, California, a teacher at Grace Christian Schools.

The defendants in the case are:

The State of California;

The California Employment Development Department;

The Director of the California Employment Development Department;

The United States of America;

The United States Department of Labor; and

The United States Secretary of Labor.

[Footnote continued on page 41a]

at trial, will be addressed in this Second Supplemental Opinion, which shall constitute the Findings of Fact and Conclusions of Law in both cases.

I. STATUTORY CONSTRUCTION

In the prior opinions filed in this case, the Court concluded that the plain meaning of the language of § 3309(b)(1) operated to exempt both Category 1 employees (i.e., persons employed directly by a church or convention or association of churches), and Category 2 employees (i.e., persons in the employ of a separate corporation formed by a church or convention or association of churches) from unemployment compensation tax coverage.[5] It seemed equally clear

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[4] [Continued]

LUTHERAN, CV 79-162 MRP

The plaintiffs in this action are:

> The Lutheran Church-Missouri Synod, a non-profit membership corporation on behalf of the eighty-five of its member churches which operate primary or secondary schools;
>
> St. John's Lutheran Church, a member of plaintiff Lutheran Church-Missouri Synod and operator of a primary school in Orange, California; and
>
> Vivadell Keiser, a teacher at the primary school operated by plaintiff St. John's Lutheran Church.

The named defendants in this action are:

> The California Employment Development Department;
>
> The Director of the California Employment Development Department; and
>
> The United States Secretary of Labor.

[5] The Court's construction of the parallel language in the California counterpart to § 3309(b)(1), Cal. Unempl. Ins. Code § 634.5(a), was, of course, identical. Moreover, because

to the Court that the same language excluded Category 3 employees (i.e., persons employed by incorporated religious schools not affiliated with a church or convention or association of churches) from the class of exempt employees. The non-church-affiliated fundamentalist schools in the Grace Brethren case (and their Category 3 employees) now challenge the conclusion that they are not exempt under the plain meaning of the statute. Specifically, the administrators and teachers of the non-church-affiliated schools contend that their schools are included in the term "church" as it appears in the exemption provisions of § 3309(b)(1).[6] Therefore, they argue, the Category 3 employees of such schools have as clear a *statutory* entitlement to exemption as the Category 1 and Category 2 employees whose tax-exempt status the Court has already recognized.

The evidence plaintiffs have submitted to support the claim that an independent fundamentalist school is a "church" in the relevant sense is extremely weak. In the testimony of an administrator of Redwood Christian Schools, the term "church" was equated (apparently on the basis of Scripture) with a "body of believers" in general, and the same witness testified to his belief that those associated with his institution constituted such a body. An expert witness testified that certain etymological ancestors of the

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Cal. Unempl. Ins. Code § 2606(a) defines covered employment for purposes of the state disability tax in the same way it is defined for purposes of the unemployment compensation tax, the Court's conclusions concerning the force of the statutory exemption apply to the disability tax as well.

[6] The evidence at trial and the argument in the Grace Brethren plaintiffs' brief were specifically directed to demonstrating that plaintiff Redwood Christian Schools is a "church".

word "church" from the old and New Testament eras included the concepts of "school" and "library" as well as that of a house of worship. One need not doubt the sincerity of plaintiffs' witnesses, however, to conclude that such testimony is of little probative value. The scope of the tax exemption accorded to employees of a "church" or a "convention or association of churches" depends, not on the meaning of "church" with the best claim to foundation in the Bible or the meaning ascribed by Greeks or Hebrews of remote antiquity to expressions from which the word "church" descended, but on the meaning of "church" in ordinary contemporary English and, in particular, its meaning to those who enacted § 3309(b)(1).

Unfortunately, the word "church" has a range of accepted definitions, varying in breadth from the narrow designation of a particular building used as a place of public worship to a comprehensive reference to the total body of Christians regarded as a spiritual society.[1] No definition of "church" appears either in the Internal Revenue Code or the California Unemployment Insurance Code. Thus, what Congress intended by the use of the term "church" in § 3309(b)(1) must be derived from an analysis of the language of the section itself and of similar language occurring in other sections of the Internal Revenue Code.

Initially, it should be noted that the *structure* of § 3309(b)(1) precludes the generic definitions of "church" offered by plaintiffs, i.e., those definitions which identify the "church" with the entire body of

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[1] For a list of the definitions of the term "church", see *Webster's Third New International Dictionary* (unabridged), G.C. Merriam & Co., Springfield, MA, (1976) p. 404.

Christian believers or with any identifiable subclass of Christian believers. Section 3309(b)(1)(A) exempts from tax those in the employ of a "church" or a "convention or association of churches." Clearly, if the term "church" had been intended to refer to the *entire* body of believers, it would have made little sense to speak, in the same subsection, of a "convention or association of churches." Similarly, § 3309(b)(1)(B) seems to presuppose a distinction between an "organization which is operated primarily for religious purposes" and the "church or convention or association of churches" which must operate, control, supervise, or support it if its employees are to be tax-exempt. The clear implication is that some religious organizations must fail to qualify as "churches". If no such distinction is maintained, a portion of the language of § 3309(b)(1)(B) is rendered meaningless and redundant.

Moreover, the fact that in both §§ 3309(b)(1)(A) and (B) the word "church" occurs in conjunction with the phrase "or convention or association of churches" at least suggests that Congress, in using those expressions, envisioned a narrower concept of "church" than that urged by plaintiffs. In particular, the phrase "convention or association of churches" is obviously suggestive of certain of the familiar protestant denominations (e.g., the Baptists) which exhibit a "congregational" ecclesiastical structure.[8]

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[8] The distinction between denominations having a "congregational" structure and those having a "hierarchical" structure is explained in Whelan, C.M. *"Church" in the Internal Revenue Code*, 45 FORDHAM L. REV. 885, 903-4 (1977) (hereafter cited as "Whelan"). The author is careful to note that the distinction is one of *ecclesiastical* structure, not of civil law corporate structure. *Id.*, at 904-5.

"Congregational" denominations are essentially consensual alliances of autonomous local congregations. While such groups of congregations may unite voluntarily to carry out certain activities (e.g., missionary work or the maintenance of a seminary), the individual local congregations are not bound by ecclesiastical law to follow a centralized church authority.[9] The phrase "convention or association of churches" is a singularly apt way of describing such a denomination. The same phrase is, strictly speaking, less accurate as a description of a "hierarchial" denomination (e.g., the Roman Catholic, Eastern Orthodox, Presbyterian, and Mormon denominations), since the local congregations of such denominations are religiously subservient to a central church authority and thus are more like subdivisions of a single religious entity than autonomous units.[10] While it would, therefore, be better to use the singular term "church" to refer to such a denomination, it is not unnatural to refer to it as a "convention or association of churches" if one focuses on the local congregations. In any case, the major point is that the phrase "convention or association of churches", which occurs in conjunction with "church" in § 3309 (b)(1), carries certain connotations of formality and institutionalization. It suggests that when Congress used the phrase "church or convention or association of churches" in § 3309(b)(1), it was refer-

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[9] *Id.*, at 904.

[10] Thus, Whelan notes, it is proper to use the term "Roman Catholic Church" to refer to *all* Catholic congregations, while it is, strictly speaking, a mistake to speak of "the Baptist Church" instead of "Baptist churches" in referring to *all* Baptist congregations. *Id.*, at 903-4.

ring to the established, institutionalized religious denominations [11] and their constituent congregations.

This impression drawn from the language of § 3309 (b) (1) is confirmed when the legislative history of some of the other Internal Revenue Code sections containing the phrase "church or convention or association of churches", and the few reported cases in which that phrase has been construed, are examined.[12] Indeed, the only potential support for plaintiffs' broad reading of "church" is an isolated sentence in a Senate report accompanying § 170(b) (1) (A) of the Internal Revenue Code of 1954, which specified the limits on the deductibility of charitable contributions. As originally enacted,[13] § 170(b) (1) (A) (i) permitted a deduction for charitable contributions to a "church or convention or association of churches" of up to 30% of a taxpayer's adjusted gross income. Contributions to other charitable organizations, including other *religious* organizations, were deductible only up to 20% of adjusted gross income.[14] However, in the original House version of

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[11] While the Court's discussion so far has referred primarily to Christian denominations and congregations because the plaintiffs are Christians and Christian institutions, the Court does not imply that the exemption of § 3309(b) (1) is so limited.

[12] A complete list of the Internal Revenue Code sections in which "church or convention or association of churches" has been used can be found in Whelan, *supra*, p. 888 n. 14.

[13] Section 170 has been amended a number of times, and the successor to the provision discussed in the text is now codified at 26 U.S.C. § 170(b) (1) (A) (i).

[14] *See* Whelan, *supra* at 907-909, for an account of the provisions and history of the original § 170(b) (1) (A).

§ 170(b)(1)(A)(i), the phrase "or a religious order" was appended to the phrase "church or convention or association of churches". The Senate Finance Committee deleted the reference to religious orders with the following explanation:

> Your committee understands that "church" to some denominations includes religious orders as well as other organizations which, as integral parts of the church are engaged in carrying out the functions of the church whether as separate corporations or otherwise. *It is believed that the term "church" should be all inclusive.* To retain the phrase "or a religious order" in this section of the bill will tend to limit the term and may lead to confusion in the interpretation of other provisions of the bill relating to a church, a convention or association of churches. Accordingly, your committee believes that the section of the bill will be clarified by this amendment.[15] [Emphasis added]

Ultimately, the Senate version was adopted by both Houses of Congress.[16] The "all inclusive" language of the Senate Report is the only scrap of legislative history which even arguably supports a reading of "church" broad enough to encompass independent fundamentalist schools like those involved in the Grace Brethren case. However, such a broad reading of "church" was expressly rejected as a construction of § 170(b)(1)(A)(i) by the Tax Court of the United States in *Vaughn* v. *Chapman*, 48 T.C. 358 (1967). In that case, the Court refused to permit

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[15] S. Rep. No. 1622, 83d Cong. 2d Sess. 30 (1954), quoted in Whelan, *supra*, at 908.

[16] *See* Whelan, *supra*, at 909.

a taxpayer to take advantage of the higher limit on deductions for contributions made to a "church or convention or association of churches" with respect to a contribution made to Missionary Dentist, Inc., an interdenominational Christian missionary organization. The Court specifically rejected the thesis that the "all-inclusive" language of the above-quoted Senate report made the term "church" synonymous with "religious organizations" in general. In part, this rejection was based on the legislative history of the tax on unrelated business income of tax-exempt organizations imposed (as an amendment to the Internal Revenue Code of 1939) by the Revenue Act of 1950, in which the phrase "church or a convention or association of churches" was used for the first time. A Senate Report accompanying that Act had drawn a strict distinction between churches and conventions or associations of churches, which were not subject to the unrelated business income tax, and admittedly *religious* organizations "organized under church auspices", which were subject to the tax. *Vaughn* v. *Chapman*, 48 T.C. at 362. The Court concluded that the imposition of differential limits on the deductibility of contributions to "churches or conventions of churches" and contributions to other religious organizations similarly implied a restrictive reading of "church" which excluded some religious organizations from its scope in spite of the "all-inclusive" language quoted above. (*Id.*, at 363).

Furthermore, the Tax Court concluded that the most probable meaning of "church", both as used in § 170(b)(1)(A) and in the quoted language of the Senate Report (which included references to "integral parts of the church" and "functions of the church") was the sense in which "church" is synonymous with

"*denomination*" or "*sect*". (*Id.*, at 363.) In spite of the fact that the Tax Court fully accepted both the contention that Missionary Dentist, Inc., was a genuinely religious organization operated primarily for evangelical purposes and the claim that its members preached and conducted religious services, it refused to accord the organization the status of a "church". The major reason for the denial of church status was the fact that the organization was a nondenominational one, committed to the advancement of general Christian principles rather than *sectarian* dogma and drawing its membership from various recognized denominations. (*Id.*, at 364.) Although *Vaughn* v. *Chapman*, *supra*, was decided under I.R.C. § 170(b)(1)(A)(i), the identity of the statutory language used in that provision and § 3309(b)(1), as well as the factual similarities[17] between the religious organizations involved in *Vaughn* v. *Chapman*, and the independent fundamentalist schools claiming to be "churches" in the instant case, makes the reasoning of the Tax Court in *Vaughn* v. *Chapman* persuasive.

Further illumination concerning the meaning of "church" is provided by a brief examination of § 511

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[17] The independent fundamentalist schools are, like the organization considered in *Vaughn* v. *Chapman*, nondenominational. Though the schools were formed and are operated predominantly for evangelical purposes, and though chapel services are conducted in the schools, the teachers and administrators of the schools are neither ordained ministers nor committed to any particular Christian denomination as a matter of school policy. Indeed, at trial, an administrator of plaintiff Redwood Christian Schools testified that formal denominational affiliation was avoided in order to broaden the appeal of the schools to parents and students of different denominations.

of the Internal Revenue Code of 1954,[18] which governs the tax on unrelated business income of tax-exempt organizations. As originally enacted, § 511(a)(2) exempted, *inter alia*, "a church, a convention or association of churches, . . ." from the tax imposed by § 511(a)(1). While this exemption was ultimately repealed by the Tax Reform Act of 1969,[19] a regulation promulgated by the Treasury Department while the exemption was in effect contains the only extended administrative interpretation of the word "church" of which the Court is aware. The regulation, found at 26 C.F.R. § 1.511-2(a)(3), provides, in pertinent part:

> (3)(i) For taxable years beginning before January 1, 1970, churches and associations or conventions of churches are exempt from the taxes imposed by section 511. The exemption is applicable only to an organization which itself is a church or an association or convention of churches. Subject to the provisions of subdivision (ii) of this subparagraph, religious organizations, including religious orders, if not themselves churches or associations or conventions of churches, and all other organizations which are organized or operated under church auspices, are subject to the tax imposed by section 511, whether or not they engage in religious, educational, or charitable activities approved by a church.
>
> (ii) The term "church" includes a religious order or a religious organization if such order or organization (a) is an integral part of a

[18] 26 U.S.C. § 511.

[19] Pub. L. No. 91-172.

church, and (b) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise. In determining whether a religious order or organization is an integral part of a church, consideration will be given to the degree to which it is connected with, and controlled by, such church. A religious order or organization shall be considered to be engaged in carrying out the functions of a church if its duties include the ministration of sacerdotal functions and the conduct of religious worship. If a religious order or organization is not an integral part of a church, or if such an order or organization is not authorized to carry out the functions of a church (ministration of sacerdotal functions and conduct of religious worship) then it is subject to the tax imposed by section 511 whether or not it engages in religious, educational, or charitable activities approved by a church.

The foregoing regulatory language is not a model of clarity. However, at least two aspects of it support the thesis that non-denominational, fundamentalist schools would not qualify as "churches". First, in subdivision (i), a strict distinction is drawn between churches and conventions or associations of churches, on the one hand, and other religious organizations organized or operated "under church auspices" on the other, even where the latter type of organizations perform religious, *educational* or charitable activities of which a "church" approves. The reference to the educational activities of religious organizations excluded from the meaning of "church" would seem to preclude classification of the independent fundamentalist schools as "churches". Second,

although subdivision (ii) does define a limited range of circumstances in which religious orders or other religious organizations may be treated as "churches", its requirement that such an organization engage in "the ministration of sacerdotal functions" certainly seems to restrict the term "church" to organizations having a formally ordained priesthood or clergy. Since formal ordination of clergy is a characteristic of the established religious denominations, it is difficult to see how a nondenominational educational institution, independent of clerical control, could qualify as a "church".[20]

The conclusion drawn from the language of the foregoing regulation is confirmed in the only reported federal district court case in which the "church" and "convention or association of churches" language of § 511 has been discussed in detail, *De La Salle Institute* v. *United States*, 195 F. Supp. 891 (N.D. Cal. 1961). In that case, a non-profit corporation composed of members of the Christian Brothers Order (a group of non-ordained monks) sued for a refund of taxes paid on unrelated business income under § 511 and its predecessor. The corporation operated a novitiate, homes for members of the Order, a winery and distillery, and Catholic *elementary and secondary schools*. Relying, in part, on the regulation quoted above and similar language in the legislative history and regulations relating to the predecessor of § 511, the court held that the Christian Brothers Order, the plaintiff corporation controlled by the Order, and all of the institutions operated by

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[20] An administrator of Redwood Christian Schools testified that neither he nor the teachers at his schools were ordained ministers.

the corporation (including the parochial schools) failed to qualify as "churches" within the meaning of the exemption provisions of § 511. Once again, the parallel implications for the classification of independent fundamentalist schools under the virtually identical language of § 3309(b)(1) and its state counterparts are obvious.

Finally, commentators have observed that the Internal Revenue Service has, over a period of twenty years, developed a working set of criteria for determining, for a variety of tax purposes, whether a particular institution is a "church". These criteria include:

> (1) a distinct legal existence, (2) a recognized creed and form of workship, (3) a definite and distinct ecclesiastical government, (4) a formal code of doctrine and discipline, (5) a distinct religious history, (6) a membership not associated with any church or denomination, (7) a complete organization of ordained ministers ministering to their congregations and selected after completing prescribed courses of study, (8) a literature of its own, (9) established places of worship, (10) regular congregations, (11) regular religious services, (12) Sunday schools for the religious instruction of the young, and (13) schools for the preparation of its ministers.[21]

As one critic observed, "In effect, the criteria require a religious organization to be a highly developed denomination before it can qualify as a church." [22]

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[21] B. Hopkins & J. Myers, The Law of Tax-Exempt Organizations 87 (1975), reprinted in Whelan, *supra*, at 925, n.164.

[22] Whelan, *supra*, at 925.

While this identification of the meaning of "church" with the established institutionalized religious denominations and their constitutent congregations has been criticized,[23] the fact remains that what legislative, regulatory, administrative, and judicial authority exists supports such a view as a matter of statutory construction.[24] Therefore, it is the opinion of this Court that the nondenominational, fundamentalist elementary and secondary schools in the Grace Brethren case cannot be classified as "churches" within the meaning of 26 U.S.C. § 3309(b)(1) and Cal. Unempl. Ins. Code § 634.5(a). As a result, the employees of such schools do not fall within the statutory exemption from the unemployment compensation tax.

II. THE CONSTITUTIONAL ISSUES

A. Questions Presented

As stated, an analysis of the plain meaning of the provisions of 26 U.S.C. § 3309(b)(1)(A) and (B) (and the parallel provisions of Cal. Unempl. Ins. Code § 634.5(a)(1) and (2)) compels the conclusion that the church-affiliated school employees in Categories 1 and 2 are exempted from unemployment compensation tax coverage, while the Category 3 employees of religious, but non-church-affiliated or nondenominational schools are covered. Moreover, because, under the Court's interpretation, the identity

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[23] See, especially, Whelan, *supra*, at 925-928.

[24] Whether the assignment of tax exemptions to "churches" defined in this denominational fashion and the withholding of exemptions from similar, but nondenominational, religious organizations is constitutional is a separate question and will be discussed at II. D., below.

of the employer, rather than the nature of the services performed, is the decisive factor in determining whether or not a particular employee is covered by the unemployment compensation tax, excessive monitoring or surveillance of the daily activities of employees of church-affiliated schools should not be necessary to the administration of the unemployment insurance scheme. Since it is not necessary (as it was under the Secretary's interpretation of the relevant statutes) to determine whether an employee spends over 50% of his or her time performing "strictly church duties," the constitutionally impermissible entanglement of the state with religion which such exemption determinations would presuppose is avoided.

However, plaintiffs have raised three additional constitutional issues which must be addressed. First, plaintiffs contend that the imposition of the unemployment compensation tax upon religious elementary and secondary schools violates the Free Exercise Clause of the First Amendment. Second, plaintiffs contend that, even if the Secretary's interpretation of the relevant statutes is rejected, the *benefit eligibility* determinations which remain necessary in the cases of individual school employees who are discharged for misconduct or who leave work without good cause pose a threat of constitutionally proscribed state entanglement with religion as great as the complicated *exemption* determinations which would have been necessary under the Secretary's view.[25] Finally, the plaintiffs in the Grace Brethren case argue that

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[25] Since the Secretary's interpretation of § 3309(b)(1) would have subjected employees of all the schools in both cases to the unemployment compensation tax, all of the plaintiffs have raised the first two constitutional issues.

if, as this Court's "plain meaning" analysis dictates, 26 U.S.C. § 3309(b)(1)(A) and (B) (and the mirror-image provisions of the California Unemployment Insurance Code) must be construed to exempt the church-affiliated school employees of Categories 1 and 2 from the unemployment compensation tax but to cover the non-church-affiliated religious school employees of Category 3, then the statutes arbitrarily discriminate in favor of the employees of the church-affiliated schools in violation of the Equal Protection Clause.

B. The Free Exercise Clause

Initially, plaintiffs argue that, in order to survive a challenge based upon the Free Exercise Clause, a statute must pass one of two tests. Specifically, it must be shown *either*:

a. That the statute does not significantly abridge interests protected by the First Amendment; or

b. That whatever burden the statute imposes on religious activity or belief is justified by a compelling state interest within the state's regulatory power.

Sherbert v. *Verner*, 374 U.S. 398 (1963); *Wisconsin* v. *Yoder*, 406 U.S. 205 (1972).

It is obvious that the plaintiffs in this case are asserting legitimate First Amendment interests. The United States Supreme Court has recognized that the operation of parochial schools may be an "integral part" of the religious mission of a particular church. *Lemon* v. *Kurtzman*, 403 U.S. 602, 616 (1971). Indeed, the evidence before this Court compels the conclusion that the dominant purpose of all of the schools which either are, or are represented by, plaintiffs in

these cases is the propagation of the Christian faith. In this respect, the schools in this case are no different from the Catholic parochial schools found to be predominantly religious in purpose and atmosphere in *Lemon* v. *Kurtzman*, *supra* and *NLRB* v. *Catholic Bishop*, 440 U.S. 490 (1979).

Similarly, there can be no doubt that the plaintiff parents and religious school teachers are asserting interests protected by the First Amendment. The right of parents to choose a religious education for their children was affirmed in *Wisconsin* v. *Yoder*, 406 U.S. 205 (1972). In that case, the United States Supreme Court invalidated a compulsory school attendance statute for interference with the rights of parents and children to practice the Amish faith, which required that any training the children received beyond a certain age take place in the Amish community, where secular influence could be minimized. Finally, although this Court remains unconvinced by the contention of certain of the plaintiff teachers that they are "ministers," either as that term is normally understood or as it is used in the exemption provision in § 2309(b)(2), the Court sees no reason to doubt the sincerity of their respective assertions that the choice of teaching in a religious school as a vocation is both a product of and an expression of religious faith. There is evidence in the record that the plaintiff teachers attempt to teach all subjects from a religious point of view, and, while it is unlikely that the content of certain courses (*e.g.*, driver's education) taught in religious schools differs from the content of the same courses as taught in secular schools, the opportunity for the injection of religious doctrine into other courses (*e.g.*, world history) is obvious. Indeed in a somewhat different

context, the United States Supreme Court has expressed some doubt that lay teachers in parochial schools could avoid engaging in religious indoctrination while teaching purportedly "secular" subjects even if they desired to do so. In *Lemon* v. *Kurtzman*, *supra*, the Court, in the course of determining whether government salary supplements to lay teachers who taught secular subjects in parochial schools would violate the Establishment Clause, stated:

> We simply recognize that a dedicated religious person, teaching in a school affiliated with his or her faith and operated to inculcate its tenets, will inevitably experience great difficulty in remaining religiously neutral. Doctrines and faith are not inculcated or advanced by neutrals. With the best of intentions such a teacher would find it hard to make a total separation between secular teaching and religious doctrine.

Lemon v. *Kurtzman*, *supra*, 403 U.S. at 618-9.

In this case, the plaintiff teachers and schools neither desire nor pretend to be "religiously neutral" or to separate secular and religious teaching. Rather, their avowed goal is to provide an education so saturated with religious doctrine and values as to ensure the transmission of their faith to succeeding generations.

Thus, the interests which plaintiffs assert are clearly within the scope of First Amendment protection. However, it is the opinion of the Court that the application of the unemployment compensation tax scheme to the employees of religious schools is not a sufficient burden on those interests to amount to a violation of the Free Exercise Clause. It is undeniable that the imposition of the tax on religious

school employees will make the operation of the schools somewhat more expensive. However, aside from the fact that the record as a whole does not support the conclusion that the effect of the additional financial burden will be significantly harmful, the mere fact that a statute renders the practice of religion somewhat more expensive is not, by itself, sufficient to bring the statute into conflict with the Free Exercise Clause. *Braunfeld* v. *Brown*, 366 U.S. 599 (1961).[26]

Plaintiffs, of course, insist that subjecting religious school employees to the tax will result in evils beyond the obvious cost increases in the operation of religious schools. Chiefly, plaintiffs argue that the prospect of being required to make increased tax contributions following the termination of employees will prevent religious schools from terminating teachers for religious reasons. For example, the principal of a religious school might desire to discharge a teacher for ineffectiveness in communicating the religious doctrine officially espoused by the institution, for failure to adhere to all points of doctrine in teaching, for lack of "religious fervor," or simply because a replacement whose religious credentials (*e.g.*, training at a religious college) are superior is available. The principal's ability to carry out his desire, plaintiffs argue, would be hampered by the possibility that the termi-

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[26] In *Braunfeld* v. *Brown*, *supra*, the United States Supreme Court sustained a state's mandatory Sunday closing law against a Free Exercise Clause challenge brought by Orthodox Jewish merchants. The Court accepted the merchants' contention that the law imposed a financial burden upon the exercise of their religion, but found that burden insufficient to render the law constitutionally invalid in light of the state's compelling interest in a uniform day of rest and the indirect nature of the financial burden itself.

nated employee would be found to be entitled to unemployment benefits and that the school's tax contribution would increase as a result. Ultimately, plaintiffs argue, the chilling effect of this on the exercise of the power to discharge employees could result in the loss of the doctrinal purity and uniformity which is so essential in religious schools.

The evidence before the Court that the foregoing evils will, in fact, occur if the unemployment compensation tax is imposed upon religious schools is rather unconvincing. There is certainly room for doubt that the prospect of increased operating costs would truly deter people for whom the propagation of religious faith is of paramount importance, as it is for plaintiffs in this case, from terminating a teacher for religious reasons. However, even if that initial problem is ignored, the mere statement of plaintiffs' position reveals that the adverse effects predicted are both indirect and entirely derived from the cost increases generated by placing religious schools within the scope of the unemployment compensation scheme. Whatever pressure those with authority to hire or dismiss teachers at religious schools might feel would be entirely financial in nature. There is no suggestion that the extension of the tax to religious schools would abridge rights to the free exercise of religion in any fashion *independent* of the financial burden which accompanies any tax. Nowhere in FUTA or its California counterparts is a direct restriction placed upon the power of administrators of religious schools to discharge school employees for any reason whatsoever, although those statutes may operate to increase the cost of certain terminations. In short, the injury to Free Exercise rights asserted by plaintiffs ultimately comes down

to the financial burden imposed by the extension of the unemployment compensation tax to these schools.

Thus, the extension of the unemployment compensation tax to religious elementary and secondary schools is not a direct prohibition or restraint of any religious practice or belief. Similarly, applying the tax to religious institutions should not be equated with the imposition of the type of direct license fee on specific religious acts by individuals which the United States Supreme Court found constitutionally infirm in *Murdock* v. *Pennsylvania*, 319 U.S. 105 (1943) and *Follett* v. *McCormick*, 321 U.S. 573 (1944). In *Murdock*, the Court invalidated a municipal ordinance which required the payment of a license tax as a condition of engaging in door-to-door solicitation as the ordinance applied to itinerant members of Jehovah's Witnesses who sold religious books and pamphlets. In *Follett*, the Court struck down a similar license tax imposed on book agents as applied to a resident evangelist and member of Jehovah's Witnesses who made his living selling similar publications. In each case, the Court found the activities of the purveyors of religious publications to be individual religious acts entirely analogous in function to the role of preaching sermons in more conventional religions. (*Murdock, supra*, 319 U.S. at 109; *Follett, supra*, 321 U.S. at 576-577). Noting that the power to impose a license tax on the exercise of constitutionally guaranteed privileges implies the power to control, or even suppress, the enjoyment of the privileges (*Murdock, supra*, 319 U.S. at 112; *Follett, supra*, 321 U.S. at 577), the Court, in each case, held that the ordinance under review infringed the freedom of speech and religion guaranteed by the First Amendment.

Although the unemployment compensation tax is an excise tax in form, it is in all other material respects different from the license fees invalidated in *Murdock* and *Follett*, *supra*. First, the unemployment compensation tax in the present context, is collected from religious institutions, not from individual religious believers. Second, the unemployment compensation tax is imposed upon the employment relationship and not upon individual religious acts. Of course, the line between the religious and secular aspects of employment at a religious school is not an altogether clear one. It is true that individual teachers and administrators may view their work as a religious calling and that the primary purpose of religious schools is to inculcate religious doctrine. It is also true that administrators of religious schools may hire or terminate employees on religious grounds. However, none of the foregoing facts transforms the hiring or firing of a teacher, or the payment of his salary, from a secular to a religious act analogous to preaching. To hold otherwise would be to adopt the view that any thing or activity remotely connected to the exercise of religion or to those who enage in it is constitutionally immunized from taxation. That no such view was intended by the United States Supreme Court in *Murdock* and *Follett*, *supra*, is demonstrated by *dicta*, in both cases, expressly approving the taxation of the income of ministers or of church property (*Murdock*, *supra*, 319 U.S. at 112; *Follett*, *supra*, 321 U.S. at 578).

Finally, the unemployment compensation tax does not share some other features of flat license fees which the United States Supreme Court found objectionable in *Murdock*, *supra*. For example, the Court in *Murdock* specifically identified, as part of a list of vices inherent in flat license fees, that such

fixed fees are unrelated to the scope of the activities of those taxed and are in no way apportioned. (*Murdock, supra,* 319 U.S. at 105-106). This is not true of the unemployment compensation tax. If a nonprofit employer elects the "reimbursement method" of contribution, its tax payments depend entirely on its employment history, for it will contribute only the amount of benefits actually found due to its former employees who leave or are discharged.[27] If the employer contributes according to the "tax rate" method,[28] the size of its tax payments varies both with the number of its employees and its past employment history. Thus, the unemployment compensation tax is quite different from the license taxes held unconstitutional in *Murdock* and *Follett, supra,* and those cases therefore do not support plaintiffs' contention that the law, as applied to religious elementary and secondary schools, violates the Free Exercise Clause.

It is thus apparent that the extension of the unemployment compensation tax to religious elementary and secondary schools is neither a direct prohibition of any religious practice nor a direct license tax on individual religious acts. However, plaintiffs quite correctly point out that the classification of a burden upon religion as "indirect" and purely financial does not automatically immunize the statute imposing the burden from further scrutiny under the Free Exer-

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[27] *See* 26 U.S.C. § 3303(e), § 3309(a)(2) and Cal. Unempl. Ins. Code § 801 *et seq.*

[28] *See* 26 U.S.C. § 3302(a)(1) and Cal. Unempl. Ins. Code § 901 *et seq.*; § 976 *et seq. See also Comment: Bringing Christian Schools Within the Scope of the Unemployment Compensation Laws* 25 VILLANOVA L. REV. 69, 77-8 (1979).

cise Clause. *Sherbert* v. *Verner*, *supra*, 374 U.S. at 403-404; *Braunfeld* v. *Brown*, *supra*, 366 U.S. at 606-607. The Court in *Braunfeld* summarized the further inquiry necessary as follows:

> Of course, to hold unassailable all legislation regulating conduct which imposes solely an indirect burden on the observance of religion would be a gross oversimplification. If the purpose or effect of a law is to impede the observance of one or all religions or is to discriminate invidiously between religions, that law is constitutionally invalid even though the burden may be characterized as being only indirect. But if the State regulates conduct by enacting a general law within its power, the purpose and effect of which is to advance the State's secular goals, the statute is valid despite its indirect burden on religious observance unless the State may accomplish its purpose by means which do not impose such a burden.

Braunfeld v. *Brown*, *supra*, 366 U.S. at 607.

The question of whether the application of the unemployment compensation tax scheme solely to the Category 3 employees, as the Court's interpretation of the federal and state statutes under review requires, discriminates between religions will be treated later in this Second Supplemental Opinion. If that question is put aside, however, it is manifest that the unemployment compensation tax scheme meets the *Braunfeld* criteria for validity under the Free Exercise Clause. The historical problems which led to the enactment of the federal statutory framework of the unemployment compensation scheme were noted in this Court's initial Opinion of September 21, 1979.

It is clear that the alleviation of the suffering which results from periods of unemployment is a thoroughly secular legislative purpose and one entirely within the power of Congress to adopt. A list of similarly secular and permissible purposes, reflecting the California legislature's concern for the economic hardship, dislocation, and instability caused by unemployment, appears at Cal. Unempl. Ins. Code § 100. Indeed, anyone having the slightest familiarity with the history of the Great Depression can have no doubt that the interest which the various unemployment compensation statutes have been designed to serve is a compelling one. The gradual extension of unemployment compensation tax coverage over the last thirty years reflects an attempt by Congress and the state legislatures to serve that interest more comprehensively. Nothing before this Court indicates that the primary effect of the unemployment compensation scheme has been anything other than the provision of the kind of relief for which it was designed.

Moreover, the unemployment compensation scheme has sufficient flexibility to permit religious schools brought within its scope some degree of control over the extent and timing of whatever financial burden they may face. Indeed, the fact that such schools have the option of choosing between alternative contribution methods [29] seems to reflect an attempt on the part of Congress and the California legislature to allow non-profit organizations to select the method of payment least likely to result in financial disruption. This effort at minimization of the unemployment compensation tax scheme's financial impact upon the plaintiffs, together with the importance of

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[29] *See* authorities cited in nn. 25 & 26, *supra*.

the interests served by the scheme and the indirect and purely financial nature of the burden it imposes upon the plaintiffs, all compel the conclusion that no violation of the Free Exercise Clause results from the inclusion of the employees of religious schools in the unemployment compensation tax scheme.

C. The Entanglement Problem

In this Court's Opinion of September 21, 1979, two distinct types of entanglement of the state with religion were identified as constitutional defects in the unemployment compensation tax scheme as applied to the various schools involved in these cases. The first form of entanglement identified was the excessive monitoring of the activities of church-affiliated school employees necessary to determine which employees fell within the exemption of 26 U.S.C. § 3309 (b)(1)(A) and (B). The entanglement of the "monitoring" variety was entirely a product of the Secretary of Labor's interpretation of the statute, which required the states to determine whether employees at the church-affiliated schools devoted over 50% of their time to "strictly church duties." As discussed above, this form of entanglement disappears once the Secretary's interpretation of the statute is rejected and the Court's "plain meaning" approach is adopted. Under the Court's interpretation, the employees of church-affiliated schools, whether those schools are unincorporated or separately incorporated, (*i.e.*, Category 1 and 2 employees) are clearly exempt, regardless of the exact nature of their activities. Equally clearly, the employees of religious schools not affiliated with churches (*i.e.*, Category 3 employees) are subject to the tax, regardless of the precise tasks they perform.

However, the Court, in its initial Opinion of September 21, 1979, identified briefly a second form of entanglement which does not disappear with the rejection of the Secretary's proposed statutory construction. This second form of entanglement arises in the context of the benefit eligibility determination process which occurs when a covered employee is discharged. Under § 3304(a)(10)[30] of the Federal Unemployment Tax Act and § 1256 of the California Unemployment Insurance Code, an employee subject to the unemployment compensation scheme is disqualified from receiving the benefits to which he would otherwise be entitled if he is discharged for misconduct. Determining whether a discharge is based on employee misconduct is, of course, a function performed by the state officer who administers the unemployment compensation program.

The entanglement problem arises in the benefit determination process not only with respect to the church-affiliated religious schools but also with respect to the religious schools without formal church affiliation. The non-church-affiliated schools are devoted to the advancement of fundamentalist Christianity and are operated by "born-again" Christians. In such institutions, adherence to the tenets of fundamentalist Christianity is a condition of employment, and the discharge of an employee for failure to observe all aspects of that creed, whether in the school or in private life, is viewed as a discharge based on misconduct. Indeed, even the Secretary's witnesses at trial, who were experienced in the administration of the benefit determination process, conceded that, in appropriate circumstances, a discharge for such religious reasons could qualify as a discharge for

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[30] 26 U.S.C. § 3304(a)(10).

"misconduct" and operate to disqualify the terminated employee from receiving unemployment benefits. Obviously, such religiously-motivated discharges would be reviewed by the state officers administering the unemployment compensation program in benefit determination proceedings. And in such proceedings, these officers would be called upon to resolve questions of religious doctrine in the process of determining eligibility, thus entangling the state with religion in a constitutionally impermissible manner.

The need to decide questions of dogma in the course of benefit determinations could arise in a number of ways. At the simplest level, a state hearing examiner could become embroiled in religious controversy while reviewing the case of a teacher discharged from a religious school over an honest disagreement on a particular point of doctrine. For example, though certain fundamentalist tenets (*e.g.*, opposition to drinking) are clear from the record and quite well known, there are other issues upon which the fundamentalist view is not widely disseminated or upon which fundamentalists are themselves divided. Suppose, then, that a teacher who either lectured on a particular topic in the classroom or simply made known his position on it were discharged by the principal of a fundamentalist school for departure from doctrine. Suppose, further, that the principal contended, and the teacher denied, that a position opposed to that taken by the teacher was a tenet of fundamentalist Christianity, and that the teacher had promised in his employment contract that he would abide by all fundamentalist principles. To determine whether the teacher's discharge was based on misconduct, so as to disqualify the teacher from benefits, the state hearing examiner reviewing the case would obviously be forced to decide whether

the teacher's or the principal's position is mandated by the fundamentalist creed.

The entanglement of the state with religion threatened by the need for unemployment compensation program administrators to adjudicate doctrinal disputes is magnified even further by the fact that not all possible sources of doctrinal controversy revolve around easily comprehensible proscriptions or permissions of specific conduct. One of the Secretary's witnesses conceded that an employment relationship may be subject to "implied rules," discharge for the violation of which could be a discharge based on misconduct. The same witness also admitted that these implied rules would vary from one religious sect to another on the basis of doctrinal differences. Moreover, certain religious commands or prohibitions seem inherently incapable of precise definition. One example presented at trial is the case of a teacher discharged for lack of "religious fervor." The discharged teacher and the school principal may well agree that "religious fervor" is a fundamentalist requirement and a condition of employment. However, they could still disagree vehemently concerning whether a particular pattern of conduct, admitted by both, amounted to a lack of religious fervor. The hearing examiner would be forced to decide that religious issue in order to determine whether the employee was entitled to benefits.

The Secretary argues that these problems of entanglement can be avoided by a state's adoption of a rule that an employee's *understanding* of the terms and conditions (including the doctrinal conditions) of his or her employment is decisive in benefit eligibility proceedings involving alleged employee misconduct. Thus, in the first of two hypotheticals posed

above, the employee would be guilty of misconduct only if he *knew* that the school principal's position was required by fundamentalist doctrine and deliberately disregarded that requirement.

The Secretary's argument with respect to the entanglement problem fails for two reasons. First, it underestimates the complexity of religious faith. In effect, the Secretary's approach requires religious schools wishing to make adherence to religious doctrine a condition of employment to develop and explain to prospective employees detailed, all-encompassing articles of religious belief. Such a task could never be accomplished. It should be obvious that not all doctrinally-based "implied work rules" can be prescribed in advance; nor can religious ideals like "fervor," which may be satisfied or breached by infinitely varied patterns of conduct, be precisely defined.

Second, the adoption of a rule making the employee's subjective understanding of his employment terms decisive would embroil the hearing examiner in credibility questions which can only be resolved by involvement in religious issues. For example, the fundamentalist school principal confronted with a claim by a teacher fired for advocacy of a particular doctrine or practice that his *understanding* of fundamentalistic doctrine did not require opposition to that doctrine or practice might well wish to challenge the credibility of the teacher's assertion by establishing that such opposition *really is* mandated by fundamentalist doctrine and that alleged ignorance of that fact *must* be feigned. Similarly, a teacher fired ostensibly for religious reasons might wish to show that the religious reasons advanced for the discharge were a pretext by showing that the reasons asserted

were not an accurate statement of the tenets of fundamentalist faith. In short, there are so many ways in which doctrinal questions could become material to benefit eligibility determinations that decisions on religious issues by secular administrators is, in this Court's opinion, inevitable if fundamentalist schools typified by some of the plaintiffs in the Grace Brethren case[31] are subjected to the benefit determination process.

This inevitable involvement of secular officials in religious disputes runs afoul of the constitutional prohibition against excessive entanglement between the state and religion which has been settled law at least since *Lemon* v. *Kurtzman*, *supra*. Indeed, the injection of secular decisionmakers into essentially religious disputes seems to be one of the more odious forms of First Amendment violation. For example, the United States Supreme Court, in *Presbyterian Church* v. *Hull Church*, 393 U.S. 440 (1969), held that a state civil court was prohibited by the First Amendment from adjudicating a church property dispute between a local church and its former parent organization because resolution of the property dispute required that the state court decide whether the parent church had "substantially departed" from its prior doctrine. Though the United States Supreme Court recognized that a state civil court is normally a perfectly appropriate forum for property disputes, including those involving church property, it held that any dispute which turned on ecclesiastical

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[31] The independent fundamentalist schools in question are Redwood Christian Schools and Christian Unified Schools of San Diego. The Court's arguments and conclusions would also apply, however, to the church-affiliated schools represented by the plaintiffs in both cases.

questions, such as the interpretation or importance of particular religious doctrines, could not constitutionally be decided by such a court. (*Id.*, 445, 450) Similarly, in *Serbian Orthodox Diocese* v. *Milivojevich*, 426 U.S. 696 (1976), the United States Supreme Court held that the First Amendment precluded civil court review of the decisions of church tribunals, not only on matters of substantive doctrine, but even for compliance with the procedural requirements of ecclesiastical law.

Finally, the history of *NLRB* v. *Catholic Bishop*, *supra*, furnishes strong support for this Court's conclusion that the need for state officials to decide religious questions in the course of benefit eligibility determinations involving former employees of religious schools is a form of entanglement prohibited by the First Amendment. In the Seventh Circuit opinion in that case (*sub. nom. Catholic Bishop of Chicago* v. *NLRB*, 559 F.2d 1112 (7th Cir. 1977), *aff'd* 440 U.S. 490 (1979)), the Court held that the First Amendment prohibited the National Labor Relations Board ("NLRB") from exercising jurisdiction over certain Catholic secondary schools. As one of the various constitutional vices in the NLRB's exercise of such jurisdiction, the Court specifically mentioned the entanglement of the NLRB in doctrinal matters which would result from the adjudication of unfair labor practice charges against the Catholic schools (559 F.2d at 1125). In fact, one illustrative example of such entanglement used by the Court was the case of a teacher ostensibly discharged for departure from Catholic tenets who claimed that the religious reasons advanced for the discharge were a mere pretext for a discharge motivated by anti-union animus. It was the view of the

Seventh Circuit that the NLRB, in processing an unfair labor practice charge filed by such a teacher, would be required to inquire into the validity, as part of church doctrine, of the reasons advanced for the discharge. (*Id.*) The similarity of the Seventh Circuit's concern over the possible role of religious questions in unfair labor practice proceedings and this Court's concern over the role of the same questions in unemployment benefit determinations is obvious.

On appeal, the United States Supreme Court affirmed the decision of the Seventh Circuit (*NLRB* v. *Catholic Bishop, supra*), albeit on different grounds. Specifically, the Court held that, because the exercise by the NLRB of jurisdiction over Catholic secondary schools would present a significant risk of infringement of First Amendment rights, the labor statutes would be construed in a manner which did *not* confer such jurisdiction on the NLRB. Thus, although the United States Supreme Court did not expressly decide the constitutional issues resolved by the Seventh Circuit, it did identify the possible First Amendment violations *threatened* by the NLRB's exercise of jurisdiction. Among the possible constitutional vices mentioned was the prospect that the NLRB would become excessively entangled with religion in the course of unfair labor practice proceedings. (440 U.S. at 502).

> The resolution of such charges by the Board, in many instances, still necessarily involve inquiry into the good faith of the position asserted by the clergy administrators and its relationship to the school's religious mission. It is not only the conclusions that may be reached by the Board which may impinge on rights guaranteed by the Religion Clauses, but the very process of inquiry

leading to findings and conclusions. [Footnote omitted] (*Id.*)

Thus, the United States Supreme Court has consistently taken the position that the resolution of questions of faith and doctrine by secular tribunals is proscribed by the First Amendment, and its latest pronouncement seems to classify religious decisions by secular officials specifically as a form of impermissible entanglement with religion. Since such entanglement is inevitable during the benefit eligibility determination process if religious schools are brought within the scope of the unemployment compensation tax scheme, constitutional considerations bar the application of the scheme to them.

D. The Discrimination Problem

The non-church-affiliated fundamentalist school plaintiffs in the Grace Brethren case raise one further constitutional objection to the extension of unemployment compensation tax coverage to them. Essentially, they argue that the exemption scheme embodied in 26 U.S.C. § 3309(b)(1)(A) and (B) and Cal. Unempl. Ins. Code § 634.5(a)(1) and (2) arbitrarily discriminates against religious schools without church affiliation and in favor of religious schools controlled and operated, directly or indirectly, by the institutionalized religious sects or denominations. The discrimination arises from the fact that the statutes under consideration, when construed according to their plain meaning, impose the financial burden of the unemployment compensation tax upon the independent religious schools while exempting the church-affiliated schools. The Grace Brethren plaintiffs argue that this disparate treatment of church-affiliated and non-church-affiliated schools is a violation of the Equal Protection Clause.

Certainly, the evidence before the Court demonstrates that there is a basic similarity between the independent fundamentalist schools in the Grace Brethren case and the church-controlled schools in both cases. The church-affiliated and non-church-affiliated schools in the two cases are virtually indistinguishable in religious mission. The overriding purpose of all the schools is to instill religious values and beliefs in young people. In each school, an attempt is made to create an environment in which religion is pervasive. An effort is made to teach all subjects, including those traditionally regarded as secular, from a religious perspective, and religion permeates extra-curricular activities as well. Indeed, an observer untrained in Christian doctrine might well have difficulty differentiating the church-affiliated schools from the independent fundamentalist schools. Thus, whatever the merits of plaintiffs' Equal Protection argument may be, it would seem that, as exercises of religion worthy of First Amendment protection, there is little to distinguish the operation of an independent fundamentalist elementary or secondary school from the operation of a school formally owned or controlled by an established denomination such as the Lutheran Church-Missouri Synod. As the Second Circuit has noted:

> It is the suffusion of religion into the curriculum and the mandate of the faculty to infuse the students with the religious values of a religious creed which create the conflict with the Religion Clauses and not the vesting of legal title or the responsibility of operation.

NLRB v. *Bishop Ford Central Catholic High School*, 623 F.2d 818, 823 (1980) *petition for cert. filed*, 49 U.S.L.W. 3496 (U.S. Dec. 22, 1980) (No. 80-

1069).[32] By classifying schools according to formal church affiliation, rather than religious mission and curriculum content, and by subjecting non-church-affiliated schools to a financial burden from which church-affiliated schools are exempt, Congress and the California legislature have accorded differential treatment to religious organizations which may well have equal status under the First Amendment. However, since this Court has already determined that application of the unemployment compensation scheme to employees of the schools involves impermissible entanglement of the state with religion, it is not necessary to reach the merits of the Grace Brethren plaintiffs' Equal Protection argument.

III. APPROPRIATE RELIEF

In its Opinions of September 21, 1979 and June 2, 1980, this Court discussed the issues surrounding the propriety of injunctive relief against the California Employment Development Department and its Director. The Court concluded that the Tax Injunction Act (28 U.S.C. § 1341) did not bar injunctive relief and that, at least with respect to Category 1 and 2 employees, the requirements for the issuance of a preliminary injunction were otherwise satisfied. Nothing in the subsequent history of this case has

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[32] In the *Bishop Ford* case, the Second Circuit held that the Supreme Court's restrictions on the jurisdiction of the NLRB established in *NLRB* v. *Catholic Church*, but applied to a Catholic school which had severed its legal connection to the local Catholic Diocese. The Court expressed the opinion that the religious character of the purposes, curriculum, and values of a school, rather than its formal church affiliation or lack of affiliation, was the decisive factor in determining its protected status under the First Amendment. 623 F.2d at 823.

changed this Court's opinion with respect to the propriety of granting injunctive relief in favor of Category 1 and 2 employees. In addition, it is clear that the Category 3 religious school employees are also entitled to injunctive relief against the state. Like their counterparts in the church-affiliated schools, the Category 3 employees will suffer irreparable injury if an injunction is not issued. Moreover, just as the remedies at law available to the Category 1 and 2 employees were previously found inadequate to alleviate the unconstitutional entanglement of the state with religion in the *exemption* determination process, the same remedies must also be classified as inadequate to alleviate the unconstitutional entanglement involved in the *benefit eligibility* determination process. The Court's injunction against assessment and collection of the state unemployment compensation tax must, therefore, be extended in favor of all of the plaintiffs and made permanent.

Moreover, the history of this litigation demonstrates the need for injunctive relief against the Secretary if the plaintiffs are to be accorded complete relief. The entire controversy arose because the Secretary adopted an erroneous construction of 26 U.S.C. § 3309(b)(1) and attempted to force the states to conform their respective unemployment compensation programs to it. As this Court noted in its initial discussion of plaintiffs' standing to sue the Secretary,[33] the Secretary's authority to decertify a state unemployment compensation program pursuant to 26 U.S.C. 3304(c) is a source of overwhelming pressure on a state to alter its program according to the Secretary's construction of federal law, even if

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[33] See the Court's Opinion of September 21, 1979, at pp. 5-7.

the Secretary's construction is unreasonable. Thus, any suggestion by the Secretary that his statutory interpretation is not a link in the causal chain leading to plaintiffs' injury must be rejected in that it fails to take into account the practical reality of the situation.

The Secretary initially avoided the issuance of a preliminary injunction against him by representing to the Court that he would not decertify California's unemployment compensation program if the state's failure to follow his interpretation of § 3309(b)(1) was due to compliance with the Court's injunction. The Secretary's assurances proved to be short-lived. When the state defendants failed to take an immediate appeal from this Court's preliminary injunction, the Secretary commenced decertification proceedings against the State of California. This renewed attempt to force the state defendants to accept the Secretary's interpretation and to require the imposition of unemployment compensation taxes upon the plaintiffs unquestionably demonstrates the need for injunctive relief against the Secretary.

The Secretary, in a somewhat cursory manner, has argued that such injunctive relief is precluded by the Anti-Injunction Act, 26 U.S.C. § 7421. That statute provides, in pertinent part:

> Except as provided in sections 6212(a) and (c), 6213(a), 6672(b), 6694(c), 7426(a) and (b)(1), and 7429(b), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

26 U.S.C. § 7421(a). A similar argument against the propriety of *declaratory* relief is possible because

of the exception for controversies involving federal taxes found in the general grant of authority to award declaratory relief in 28 U.S.C. § 2201.[34] Because the limits which these two statutes impose upon the jurisdiction of the federal courts are coterminous in scope,[35] only the objection to injunctive re-

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[34] 28 U.S.C. § 2201 provides:

> In a case of actual controversy within its jurisdiction, *except with respect to Federal taxes* other than actions brought under section 7428 of the Internal Revenue Code of 1954, or a proceeding under section 505 or 1146 of title 11, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such. [Emphasis added]

[35] The United States Supreme Court has declined to resolve the question of whether the federal tax exception to the Declaratory Judgment Act in 28 U.S.C. § 2201 is coextensive with, or broader than, the scope of the prohibition of the Anti-Injunction Act in 26 U.S.C. § 7421. The Court has only held that the federal tax exception to the Declaratory Judgment Act is "at least as broad" as the Anti-Injunction Act. *See Bob Jones University* v. *Simon*, 416 U.S. 725, 732-3 n.7. The Court did, however, cite several lower court decisions holding that the two statutes are coterminous in application (*Id.*). At least one commentator has identified that conclusion as the majority view among the courts which have squarely faced the issue of the comparative scope of 26 U.S.C. § 7421 and the federal tax exception to 28 U.S.C. § 2201. *See* Asofsky, P.H., *Injunctions and Declaratory Judgments in Federal Tax Controversies*, 28 RUT.L.REV. 785, 799-800 (1975), and cases cited therein. *See also Chapman* v. *Alexander*, 421 F. Supp. 930 (W.D. La. 1976), *aff'd* 552 F.2d 367; *Dietrich* v. *Alexander*, 427 F. Supp. 135 (E.D. Pa. 1977). This Court finds particularly persuasive a series of cases from

lief based on the Anti-Injunction Act will be considered explicitly.

The most obvious answer to the Secretary's challenge to the Court's power to order injunctive relief against him is that the statute upon which he relies is inapplicable. 26 U.S.C. § 7241(a) operates to bar suits for injunctions against the assessment or collection of *federal* taxes. *See Enochs* v. *Williams Packing Co.*, 370 U.S. 1, 5 (1962). However, the plaintiffs in this case do not seek to be relieved of

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the District of Columbia Circuit in which the two statutes were held to be coterminous. *Eastern Ky. Welfare Rights Org.* v. *Simon*, 506 F.2d 1278 (D.C. Cir. 1974), *vacated on other grounds sub. nom. Simon* v. *Eastern Ky. Welfare Rights Org.*, 426 U.S. 26 (1976); *"Americans United", Inc.* v. *Walters*, 477 F.2d 1169 (D.C. Cir. 1973), *rev'd on other grounds sub. nom. Alexander* v. *"Americans United", Inc.*, 416 U.S. 752 (1974); *McGlotten* v. *Connally*, 338 F. Supp. 448 (D.D.C. 1972) (three-judge court). In those cases, the conclusion that the two statutes are coterminous was supported, in part, by the inherent paradox in construing the power to grant injunctive relief in federal tax cases more broadly than the power to grant declaratory relief, and in part by an analysis of the legislative history of the federal tax exception in 28 U.S.C. § 2201, which indicated that that exception was added to the Declaratory Judgment Act specifically for the purpose of preventing taxpayers from using the declaratory relief available under § 2201 as a means to circumvent the prohibition of the Anti-Injunction Act. This Court is of the opinion that, for the same reasons, the Ninth Circuit would also regard the two statutes as coterminous in spite of its earlier implication to the contrary in *Martin* v. *Andrews*, 238 F.2d 552 (9th Cir. 1956). Aside from the greater inherent sense of the position developed subsequently by the D.C. Circuit, the Ninth Circuit's suggestion, in *Martin*, that the Anti-Injunction Act is subject to exceptions to which the bar of the federal tax provision of the Declaratory Judgment Act is not subject was unnecessary to the disposition of the case. *See* Asofsky, *supra*, 28 RUT. L. REV. 800, n. 81.

any federal tax liability. All the schools involved in both of the cases before the Court are exempt from *federal* unemployment tax liability by virtue of 26 U.S.C. § 3306(c)(8). Indeed, even the Secretary, when objecting to plaintiffs' standing to sue the federal defendants, argued that the only financial burden to which plaintiffs have been subjected is the result of *state*-imposed unemployment compensation and disability taxes. The Court has, of course, recognized that the Secretary's erroneous interpretation of federal law is causally responsible for the construction of *state* law which resulted in the imposition of those state taxes on church-related schools. That is, indeed, the major reason plaintiffs have standing to sue the Secretary. However, the fact that the extension of the state taxes under consideration to church-affiliated schools was, in large measure, a result of the Secretary's interpretation of federal law does not alter their character as *state* taxes. Thus, § 7421 is literally inapplicable, and, since the Court has already considered, and rejected, a challenge to its power to enjoin the collection of *state* taxes based on 28 U.S.C. § 1341, there would appear to be no barrier to an award of injunctive relief against both the federal and state defendants.

Nevertheless, the Court recognizes that, because of the last clause of 26 U.S.C. § 7421(a), *i.e.*, "whether or not such person is the person against whom such tax was assessed", and certain expansive language in the cases decided under § 7421,[36] there is some

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[36] For example, the United States Supreme Court has said:

> Section 7421(a) does not bar merely a taxpayer's attempt to enjoin the collection of his own taxes. Rather, it declares in sweeping terms that "no suit for the purpose of restraining the assessment or collection of any tax

basis for arguing that § 7421 applies to the instant case. Thus, it could be argued, enjoining the Secretary from interpreting § 3309(b)(1) so that the employees of church-related schools must be covered under a state's unemployment compensation program, and from forcing the state to adopt a similar construction of its own law, is tantamount to enjoining the Secretary from instituting decertification proceedings against the state. Absent such an injunction, the Secretary would be free to prosecute decertification proceedings if he chose to do so, and it is possible that he might be successful in those proceedings. If the Secretary did prevail in decertification proceedings, the employers in the state who are covered under the Federal Unemployment Tax Act would lose the credit against the federal tax which 26 U.S.C. § 3302(a) provides for contributions to a *certified* state unemployment compensation plan. Obviously, in that case, the federal unemployment tax liability for the state's employers would be increased as a result of the decertification. Thus, it

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> shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." [Footnote omitted] Thus a suit to enjoin the assessment or collection of anyone's taxes triggers the literal terms of § 7421(a).

Commissioner v. *"Americans United", Inc.*, 416 U.S. at 760. Similarly, the Ninth Circuit has stated:

> Likewise, this statutory ban against judicial interference with the assessment or collection of taxes "is equally applicable to activities which are intended to or may culminate in the assessment or collection of taxes." *United States* v. *Dema*, 544 F.2d 1373, 1376 (7th Cir. 1976), *cert. denied* 429 U.S. 1093, 97 S.Ct. 1106, 51 L.Ed.2d 539 (1977).

Blech v. *United States*, 595 F.2d 462, 466 (9th Cir. 1979).

could be argued, an injunction against the Secretary precludes a *potential* increase in federal tax receipts, and such an injunction is, therefore, a restraint against the assessment or collection of a federal tax within the meaning of § 7421(a).

The foregoing argument need only be stated to reveal that the potential effect on federal tax revenues upon which the argument relies is not only indirect, but highly contingent as well. This Court has grave doubts that § 7421 should be triggered whenever relief is requested which has some conceivable impact on federal tax receipts.[37] However, assuming

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[37] The Court is aware that in the companion cases of *Bob Jones University* v. *Simon*, 416 U.S. 725 (1974), and *Commissioner* v. *"Americans United", Inc.*, 416 U.S. 752 (1974), the United States Supreme Court found § 7421 applicable and operative to bar a suit to enjoin the revocation of an Internal Revenue Service ruling letter classifying a particular organization as tax-exempt under 26 U.S.C. § 501(c)(3). In each case, one purpose of the plaintiff organization's suit was to prevent its donors from losing the tax deduction which 26 U.S.C. § 170 provides for contributions to organizations which qualify under § 501(c)(3). The donors' potential loss of a deduction in those cases is somewhat analogous to the potential loss of the § 3302 tax credit for contributions to a certified state unemployment compensation fund faced by employers covered under FUTA in the event the Secretary decertifies a state program. Although this Court is of the opinion that *Bob Jones University* and *"Americans United"* are distinguishable from the instant cases, both because the plaintiff in each of the former cases had some federal tax liability of its own and because the possibility of an effect on federal tax revenues in the instant cases is somewhat more speculative, it is arguable that the two cases cited above make § 7421 applicable to the instant cases. For that reason, a discussion of an exception to § 7421 has been included below.

arguendo that the foregoing argument is accepted and § 7421 is applicable, the instant case falls within a narrow exception to the prohibitions of § 7421 formulated in *Enochs* v. *Williams Packing Co.*, 370 U.S. 1 (1962) and reaffirmed in *Bob Jones University* v. *Simon*, 416 U.S. 725 (1974) and *Commissioner* v. *"Americans United" Inc.*, 416 U.S. 752 (1974). In order to qualify for this exception and escape the ban on injunctive relief codified in § 7421, the proponent of injunctive relief must demonstrate, first, that his success on the merits of his case is certain (*i.e.*, that, under no circumstances could the government prevail in an attempt to enforce the tax in issue) and, second, that irreparable injury would occur absent an injunction. *Enochs* v. *Williams Packing Co.*, 370 U.S. at 7; *Bob Jones University* v. *Simon*, 416 U.S. at 737; *Commissioner* v. *"Americans United" Inc.*, 416 U.S. at 758, 762. Moreover, the likelihood of the government's success in enforcing the tax in dispute is to be assessed on the basis of information available to the government at the outset of the lawsuit in which injunctive relief is sought. *Enochs* v. *Williams Packing Co.*, 370 U.S. at 7; *Bob Jones University* v. *Simon*, 416 U.S. at 737. Thus, the criteria for applying the exception to § 7421 are quite strict, and only a narrow range of cases will escape the ban on injunctive relief in cases involving federal taxes.

The instant case unquestionably fits within the narrow scope of the exception. This Court has already indicated that the second component of the *Williams Packing* test is satisfied. The injury which would be inflicted by permitting the Secretary to continue to interpret § 3309(b)(1) erroneously and to force the states to adopt his interpretation is irreparable, both because it involves the deprivation of

constitutional rights [38] and because the available legal remedies (*e.g.*, refund suits) are incapable of redressing non-financial forms of injury like the *intrusion* involved in excessive entanglement of the state with religion.

The first prong of the *Williams Packing* test, *i.e.*, certainty of success on the merits, is also satisfied, and it was satisfied at the beginning of this litigation. All of the information necessary to decide the issue of the propriety of the Secretary's construction of § 3309(b)(1) was known to the Secretary and before the Court when the complaints were filed. Thus, at the outset of the litigation, without the development of further facts, it was clear that under no circumstances could the Government prevail on the merits on the question of the plain meaning of the statute. Similarly, once the Secretary's "strictly church duties" test was understood, it was quite obvious that its enforcement would require excessive

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[38] See discussion and cases cited in the Court's Opinion of September 21, 1979, pp. 13-16. This Court is, of course, aware of the language in *Commissioner* v. *"Americans United"*, *supra*, to the effect that the constitutional nature of a taxpayer's claim, "as distinct from its probability of success" is "of no consequence" under the Anti-Injunction Act. However, read in context, this language does *not* reflect a view on the part of the United States Supreme Court that *constitutional* injury cannot be *irreparable* injury sufficient to satisfy the second prong of the test for an exception to the Anti-Injunction Act. Rather, the point of the language is that the fact that the injury alleged is constitutional in nature is no substitute for satisfaction of the *first* prong of the test for an exception to the statute's prohibition, *i.e.*, certainty of success on the merits. Even if a taxpayer's claim to an injunction is *constitutional* in nature, he must show that he is entitled to prevail on it.

monitoring of the activities of employees of church-affiliated schools. Indeed, from the outset, there was never any serious dispute that such monitoring was occurring. Likewise, the Court had no doubt at any time that such monitoring fell within the constitutional prohibitions against excessive entanglement of the state with religion enunciated in *Lemon* v. *Kurtzman, supra*, and the other decisions of the United States Supreme Court which have been discussed. Thus, insofar as the injury to plaintiffs was traceable to the Secretary's actions and interpretation of federal law, plaintiffs' success on the merits, on both statutory and constitutional grounds, was certain at the time the suits were filed. Therefore, even if the instant cases involve the type of suit to which 26 U.S.C. § 7421 applies, the requirements for an exception to the statute's ban on injunctive relief are met. Accordingly, appropriate injunctive relief will issue against the federal, as well as the state, defendants.[39]

DATED:

MARIANA R. PFAELZER
United States District Judge

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[39] At this time, the Court has no information indicating what response, if any, the Secretary will make to the Court's conclusion that the state defendants may not constitutionally impose the state unemployment compensation tax scheme on the Category 3 employees of non-church-affiliated schools. Since such employees were, under any construction of the relevant statutes, subject to the unemployment compensation scheme, the Secretary concentrated his attention on the Category 1 and 2 employees, whose status his erroneous statutory interpretation affected. If the Secretary, in response to failure by the state defendants to collect unemployment compensation taxes on behalf of Category 3 employees, institutes decertification proceedings against the State of California, the parties may apply to this Court for further relief.

APPENDIX F

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Case No. CV 79-9[illegible] MRP

GRACE BRETHREN CHURCH and
REVEREND DAVID L. HOCKING, ETC., ET AL.,
PLAINTIFFS

v.

STATE OF CALIFORNIA, ETC., ET AL., DEFENDANTS

Filed Apr. 3, 1981

Entered Apr. 6, 1981

ORDER AND JUDGMENT

This cause came on for trial before the Honorable Mariana R. Pfaelzer, sitting without a jury, on August 12 and 13, 1980. The Court, having considered the pleadings, post-trial briefs, evidence and arguments of counsel, has determined that plaintiffs are entitled to relief and that the preliminary injunction granted by the Court by Order of September 21, 1979, and clarified by Order of June 2, 1980, must now be extended in scope and made permanent. Therefore, in accordance with the Findings of Fact and Conclusions of Law contained in the Second Supplemental Opinion filed herewith,

IT IS ORDERED, ADJUDGED AND DECREED:

1. That 26 U.S.C. § 3309(b)(1) and California Unemployment Insurance Code § 634.5(a), if inter-

preted according to the defendant Secretary of Labor's "strictly church duties" test and applied to schools (whether unincorporated or separately incorporated) which are operated, supervised, controlled, or principally supported by a church or convention or association of churches, are unconstitutional. Both statutes, so interpreted and applied, are incompatible with the Religion Clauses of the First Amendment (as made applicable to the states by the Fourteenth Amendment) because they result in two forms of excessive entanglement of the state with religion:

(a) Intrusive monitoring of the activities of employees of religious schools in order to determine whether or not those employees are exempt from unemployment insurance and disability taxes; and

(b) Involvement of state officials in the resolution of questions of religious doctrine in the course of determining the benefit eligibility of discharged employees of religious schools.

The schools to which this paragraph applies are:

Grace Christian Schools, which are affiliated with plaintiff Grace Brethren Church of Long Beach, California;

Highlands Academy, which is affiliated with plaintiff Calvary Cross Church of the Highlands, located at San Bruno, California; and

2. That 26 U.S.C. § 3309(b)(1) and California Unemployment Insurance Code § 634.5(a), properly interpreted according to their plain meaning, exempt the employees of the schools listed in Paragraph 1

from California unemployment compensation tax and disability taxes.

3. That 26 U.S.C. § 3309(b)(1) and California Unemployment Insurance Code § 634.5(a), properly interpreted according to their plain meaning, do not exempt the employees of plaintiffs Redwood Christian Schools and Christian Unified Schools of San Diego, which are neither churches nor operated, supervised, controlled, or principally supported by a church or convention or association of churches, from unemployment compensation and disability taxes.

4. That, as applied to the employees of plaintiffs Redwood Christian Schools and Christian Unified Schools of San Diego, California Unemployment Insurance Code § 634.5(a) is unconstitutional. That statute, so applied, is incompatible with the Religion Clauses of the First Amendment (made applicable to the states by the Fourteenth Amendment) because it results in excessive entanglement of the state with religion in the form described in Paragraph 1(b) above.

5. That defendants State of California, the California Unemployment Development Department and its Director, and their officers, agents, employees, representatives, and all persons acting under or in concert with them, are hereby permanently enjoined and restrained from collecting, or attempting to collect, unemployment compensation or disability taxes from any of the churches or schools mentioned in Paragraphs 1 and 4 of this Order on behalf of the employees of the schools. The aforementioned defendants are further enjoined from collecting, or attempting to collect, information from the schools or churches mentioned in Paragraph 1 for the purpose of ascertaining whether or not employees of such schools

spend at least 50% of their time performing "strictly church duties". Defendants may, without violating this Order, obtain from such schools verification of church affiliation.

6. That the defendants United States of America, United States Department of Labor, United States Secretary of Labor, their officers, agents, employees, representatives, and all persons acting under or in concert with them, are hereby permanently enjoined and restrained from interpreting 26 U.S.C. § 3309 (b)(1) in a manner which requires state unemployment compensation plan administrators to collect contributions on behalf of employees of church-affiliated schools who fail to prove that they spend more than 50% of their time performing strictly church duties, and from forcing or attempting to force any other person or agency to adopt such an interpretation.

7. That judgment is hereby entered in favor of plaintiffs.

DATED: March 31, 1981

/s/ Mariana R. Pfaelzer
MARIANA R. PFAELZER
United States District Judge

APPENDIX G

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

No. CV 79-093-MRP

GRACE BRETHREN CHURCH and
REVEREND DAVID L. HOCKING, ETC., ET AL.,
PLAINTIFFS

v.

STATE OF CALIFORNIA, ETC., ET AL., DEFENDANTS

No. CV 79-162-MRP

THE LUTHERAN CHURCH—MISSOURI SYNOD, a non-profit membership corporation on behalf of 85 member Lutheran Churches, ETC., ET AL., PLAINTIFFS

v.

THE STATE OF CALIFORNIA EMPLOYMENT
DEVELOPMENT DEPARTMENT, ET AL., DEFENDANTS

NOTICE OF APPEAL

Filed Apr. 29, 1981

The United States of America, on behalf of the federal defendants, hereby appeals to the Supreme Court of the United States, pursuant to 28 U.S.C. 1252 and 2101(a), from the judgments of this Court filed on April 3, 1981, and entered on April 6, 1981.

Dated: This 29th day of April, 1981.

/s/ Andrea Ordin
ANDREA SHERIDAN ORDIN
United States Attorney

APPENDIX H

SUPREME COURT OF THE UNITED STATES

No. A-1054

UNITED STATES, ET AL., APPELLANTS

v.

GRACE BRETHREN CHURCH, ET AL.

and

UNITED STATES, ET AL., APPELLANTS

v.

LUTHERAN CHURCH—MISSOURI SYNOD, ET AL.

ORDER

UPON CONSIDERATION of the application of the Solicitor General,

IT IS ORDERED that the time for docketing an appeal in the above-entitled cases be, and the same is hereby, extended to and including August 3, 1981.

/s/ William H. Rehnquist
Associate Justice of the
Supreme Court of
United States

Dated this 19th day of June, 1981.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1981 351090 849

Motion to Dismiss or Affirm

Office-Supreme Court, U.S.
FILED
SEP 8 1981
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CLERK

No. 81-228

IN THE

Supreme Court of the United States

October Term, 1980

UNITED STATES OF AMERICA, ET AL.,
Appellants

v.

GRACE BRETHREN CHURCH, ET AL.,
Appellees

On Appeal From the United States District Court
for the Central District of California

MOTION TO AFFIRM

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COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Does the Tax Injunction Act bar a district court from exercising jurisdiction in respect to a complaint which makes substantial claims under the Religion Clauses of the First Amendment challenging the imposition of a state tax, where a state's constitution and statutes prohibit initial resort to the state's courts but instead require the claimant to pursue protracted administrative proceedings in which constitutional issues are barred from consideration and which involve excessive entanglement of government with religion?

2. Does imposition of the Federal Unemployment Tax Act upon pervasively religious schools which, though not operated by churches, are indistinguisable from them in religious character and mission, violate rights guaranteed such schools by the Religion Clauses of the First Amendment?

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No. 81-228

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

UNITED STATES OF AMERICA, et al.,
Appellants

v.

GRACE BRETHREN CHURCH, et al.,
Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

MOTION TO AFFIRM

The appellees Grace Brethren Church and Reverend David L. Hocking, its pastor; Calvary Cross Church of the Highlands and Reverend Donald B. Sheeley, its pastor; Scott Memorial Baptist Church and Reverend Tim Lahaye, its pastor; Christian Unified Schools of San Diego; Redwood Christian Schools; Sidney Bowen and Patricia Bowen, his wife; Peter Farrelly and Sue Farrelly, his wife; William Tschantz and Janet Tschantz, his wife; Arthur Brandwood and Cheryl Brandwood, his wife; Stanley Edington; R. Florence Murti; and R. Suzanne Royer, respectfully move to affirm the judgment of the United States District Court for the Central District of California entered April 6, 1981, insofar as that judgment is challenged by this appeal.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U. S. Constitution, Amendment I:

> Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . .

26 U. S. C. 3309(b):

> This section shall not apply to service performed:
>
> > (1) in the employ of (A) a church or convention or association of churches, or (B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches . . .

28 U. S. C. 1341 (Tax Injunction Act):

> The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

California Unemployment Insurance Code § 634.5:

> With respect to . . . any nonprofit organization described by Section 608, "employment" does not include . . . service performed in any of the following:
>
> > (a) In the employ of (1) a church or convention or association of churches, or (2) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches.

COUNTERSTATEMENT OF THE CASE

On January 8, 1979, the appellees (the plaintiffs below) brought this action in the district court against the United States and the State of California. Among the plaintiffs were pervasively religious schools (Redwood Christian Schools) which are operated exclusively for religious purposes but are not operated, supervised, controlled, or primarily supported by a church or convention or association of churches. The complaint challenged the imposition, upon these schools, and upon the plaintiff church-operated schools, of the Federal Unemployment Tax Act ("FUTA") 26 U. S. C. § 3301, *et seq.*, and the corresponding California Unemployment Insurance Code, upon the grounds that (a) the acts did not apply to employees of the plaintiff schools operated by churches, (b) the acts could not be applied either to such schools or to the plaintiff non-church-operated schools without violation of the Religion Clauses of the First Amendment. Both declaratory and injunctive relief were sought.

The federal defendants, on March 8, 1979, moved to dismiss the complaint on the ground that the district court, by virtue of the Tax Injunction Act, lacked jurisdiction over the subject matter of the action. The district court, on September 21, 1979, issued a preliminary injunction. Jurisdictional Statement, App. A, 1a-22a; App. B, 23a-24a. On November 19, 1979, the federal defendants filed, in the district court, a notice of appeal to the United States Court of Appeals for the Ninth Circuit, the appeal being docketed under Nos. 79-3763 and 79-3754. On February 12, 1980, and March 28, 1980, the federal defendants moved in the Ninth Circuit for extension of time to file their opening brief. On June 2, 1980, the district court issued a Supplemental Opinion and Order Granting Pre-

liminary Injunction. Jurisdictional Statement, App. C, 25a-34a; App. D, 35a-37a. On July 24, 1980, the parties having entered into a stipulation for dismissal pursuant to F. R. A. P. 42(b), the Ninth Circuit issued an Order of Dismissal (App. A). The district court, on April 6, 1981, issued a permanent injunction enjoining the imposition of the act on statutory and constitutional grounds.[1] The United States filed a notice of appeal to this Court on April 29, 1981. Jurisdictional Statement, App. G, 91a-92a. Justice Rehnquist extended until August 3, 1981, the time in which to docket the appeal. The appeal by the United States is pursuant to 28 U. S. C. § 1252.

---

1. The district court held that the imposition of the unemployment tax program on the church-schools (whether incorporated separately from a church or not) (a) is barred by the plain meaning of § 3309(b)(1) of the federal act which exempts church employees, and (b) creates excessive church-state entanglements forbidden by the Establishment Clause. The court also held that application of the act to the non-church religious schools would be "incompatible with the Religion Clauses of the First Amendment . . . because they result in excessive entanglement of the state with religion . . ." Jurisdictional Statement, App. F at 88a.

ARGUMENT

The Government urges two points: (1) that the district court lacked jurisdiction in that it was barred by the Tax Injunction Act to grant injunctive relief in this case, (2) that the district court erred in holding that imposition of the unemployment compensation program on the Redwood Christian Schools would create excessive entanglements between government and religion barred by the Establishment Clause. Neither point has substance.

1. The District Court Had Jurisdiction to Grant Injunctive Relief.

The Government, citing the Tax Injunction Act, 28 U. S. C. § 1341, now[2] contends that the appellees had a plain, speedy and efficient remedy in California's courts. The Government argued this assertion extensively in the district court, which carefully distinguished the cases there (and here) cited by the Government from the situation presented by the case at bar. Here are involved Religion Clause claims of religious institutions and persons, and the district court recognized that cases not involving these claims and claimants are not necessarily controlling. The principal point made by the district court is low-keyed

2. The Government, early in the litigation, had moved to dismiss on the ground that the Tax Injunction Act deprived the district court of jurisdiction. That court's preliminary injunction and opinion of September 21, 1979, denied that motion, and the Government then timely appealed to the Ninth Circuit which, on July 24, 1980, dismissed the appeal (following a stipulation by all parties for dismissal). While the present appeal, insofar as it pertains to the non-church-operated schools, is timely, in that the district court issued an injunction protecting them only on April 6, 1981, it is questionable whether the appeal, insofar as it pertains to the Tax Injunction Act, should be regarded as timely. If not, it should, in that respect, be dismissed.

to a footnote in the Jurisdictional Statement (Page 9, fn. 10)—where it is unanswered.[3] To air it here will show conclusively that the Government's contention is baseless and that it was imperative that the court below exercise jurisdiction.

The religious plaintiffs below presented First Amendment claims obviously calling for prompt disposition by a body competent to adjudge those claims. Section 3.5 of Article III of the California Constitution provides:

> "An administrative agency . . . has no power . . . (b) to declare a statute unconstitutional."

The plaintiffs, if forced to pursue their pressing claims via administrative agencies, would have been detoured on a route to ultimate meaningful judicial review which would have constituted a briarpath of entanglements of government with religion. That detour would not have been "plain, speedy and and efficient" but complicated, slow, inefficient and—to religious bodies which accept no public aid and have but modest means through voluntary contributions of the faithful—inordinately expensive.[4]

---

3. The district court initially pointed out that, due to the effects of Article XIII, § 32, of the California Constitution, and of § 1851 of the California Unemployment Insurance Code, "the availability of injunctive relief is, at best, uncertain." Jurisdictional Statement, App. A, 17a.

4. The assuming of jurisdiction by district courts is proper, and exhaustion of administrative remedies not required, where the administrative process and review procedures would be inadequate to protect the constitutional rights of the party seeking district court action. *Public Utilities Commission of California v. United States*, 355 U. S. 534, 539 (1958); *McCulloch v. Sociedad Nacional*, 372 U. S. 10, 17 (1963); and see detailed discussion in *McCormick v. Hirsch*, 460 F. Supp. 1337, 1341-1348 (M. D. Pa. 1978).

The "remedy" which appellees would have been forced to pursue, if turned away from federal court under Section 1341, would have been no remedy at all. For to force religious persons to entangle themselves with government, in the form of the full range of California administrative regulation, investigation and adjudication, is precisely the kind of constitutional damage which appellees had sought to avoid by this action. This administrative relationship between government and religion, touching sensitive areas of religious concern central to the religious mission of these religious organizations, is here a source of harm to fundamental liberties. This administrative relationship is scarcely the remedy for the harm it inflicts. As this Court has recognized:

> "It is not only the conclusions that may be reached by the Board which may impinge on rights guaranteed by the Religion Clauses, but the *very process of inquiry* leading to findings and conclusions." *NLRB v. Catholic Bishop of Chicago*, 440 U. S. 490, 502 (1979) (Emphasis supplied).

The California Unemployment Insurance Code, if here applied, would impose on churches, pastors and religious schools extremely extensive and complicated registration, record-keeping, reporting and informational requirements. (See California Unemployment Insurance Code, §§ 1085, 1086, 1088(a), 1088(b), 1092, 2105 and 2108, all of these being accompanied by criminal penalties.) Section 1089, if here applied, would require a church or other religious school to post printed statements concerning benefit rights of employees within its ministry "and other matters as may be prescribed by authorized regulations".

The California Employment Development Department would be empowered to:

(a) make investigations to determine whether a religious school, or employee thereof, is covered by the Code. See Section 1953 and *Hill v. Brisbane*, 66 Cal. App. 2d 15, 151 P. 2d 518 (1944);

(b) issue subpoenas to compel the attendance of witnesses and the production of books, papers, correspondence, memoranda and other records of religious institutions (Section 1953);

(c) make an assessment, including a penalty of 10%, upon a religious school which fails to make returns, and to do so on the basis of an estimate arrived at according to whatever information may be in the Department's hands (Section 1126);

(d) assess a penalty of 25% on pastors of religious schools who, as a matter of religious conscience, wilfully fail to comply with the requirement to file returns (Section 1128);

(e) obtain imposition of a lien on all religious property for failure to pay contributions (Section 1703);

(f) charge pastors or deacons or others who are responsible for religious affairs with personal liability for amounts of contributions due (Section 1735);

(g) obtain a summary judgment against a church or religious school for failure to pay contributions (Section 1815); and

(h) bring legal actions, in the courts of California or the United States, against churches, religious schools, pastors and deacons to collect the amount of

any delinquent employer or worker contributions, together with penalties and interest (Section 1852).

All of this is excessive entanglement between government and religion as well as an unjustifiable burden upon free religious choice. *Lemon v. Kurtzman*, 403 U. S. 602 (1971); *Catholic Bishop of Chicago v. NLRB*, 559 F. 2d 1112 (7th Cir. 1977), *aff'd.* 440 U. S. 490 (1979); *Surinach v. Pesquera des Busquets*, 604 F. 2d 73 (1st Cir. 1979).

The churches and religious schools are therefore required to march to orders of the government through the course of the investigatory phases of administrative action and conform their practices to government demands. After they have been burdened by investigatory, accounting and reporting requirements, they must take their funds—funds held as a religious trust for their members—and apply those funds to secular governmental purposes. Only at this point may a hearing be sought, but this is to be an administrative hearing, before a referee, and cannot touch matters of the constitutionality of the Federal Unemployment Tax Act under the Religion Clauses of the First Amendment. See *Buckeye Industries v. Secretary of Labor*, 587 F. 2d 231 (5th Cir. 1979). The referee's decision is then brought before an Appeals Board for review. The Appeals Board consists of five members, not more than two of whom need even be attorneys. (Code Section 401). This Board likewise may not judge the constitutionality of the Federal Unemployment Tax Act (and cannot be expected to reflect any expertise in the area of First Amendment liberties). Only after this administrative process has been exhausted may a religious body have access to the California state courts, and then only by means of claim for refund of amounts of money already paid.

The appellees thus faced the Hobson's choice of either obeying religious conscience by refusing to permit the government to intrude upon their religious mission (and thereby subjecting themselves to personal loss, to the diverting of funds intended for religious uses, and bringing on financial hardship), or foregoing the exercise of religious conscience (under government edict) by complying with the unemployment insurance procedural requirements. *Sherbert v. Verner*, 374 U. S. 398, 404 (1963); *Thomas v. Review Board*, — U. S. —, 49 U. S. L. W. 4341, 4344 (1981). Their religious liberties, under the prescribed procedure, would be at least temporarily suspended by government. But liberties suspended are liberties lost, and where fundamental liberties are in jeopardy of being lost, this Court has held that the lesser government concerns with administrative convenience must give way. Thus, where challenge is raised not merely to possible final outcome of an administrative procedure, but rather to the constitutionality of the procedure itself, a federal court need not stand by until the damage has been done, *Public Utilities Commission of California v. United States*, 355 U. S. 534, 539 (1958); *Glover v. St. Louis-San Francisco Railway Co.*, 393 U. S. 324, 330 (1969); *Weinberger v. Salfi*, 422 U. S. 749, 765 (1975); *Matthews v. Diaz*, 426 U. S. 67, 73 (1976); *Califano v. Sanders*, 430 U. S. 99, 109 (1977); *Moore v. City of East Cleveland*, 431 U. S. 494 (1977), Burger, J., dissenting at 528, Fn. 3; and *Oestereich v. Selective Service Board*, 393 U. S. 233, 241 (1968), Harlan, J., concurring.

While this Court has held that § 1341 will not bar federal jurisdiction where the presence of an adequate state remedy is "uncertain", *Spector Motor Service v. McLaughlin*, 323 U. S. 101 (1944), *Township of Hillsborough v. Cromwell*, 326 U. S. 620 (1946), it has most recently pointed out that "A federal district court is under an

equitable duty to refrain from interfering with a State's collection of its revenue *except in cases where an asserted federal right might otherwise be lost*". *Tully v. Griffin, Inc.*, 428 U. S. 68, 73 (1976). (Emphasis supplied). It is difficult to imagine a situation where it is more "certain" that fundamental rights would be lost without federal intervention than that presented by the instant case. Even in the pure property right situation involved in *Tully*, the Supreme Court was concerned over whether New York law permitted preliminary court relief to persons facing a sales tax assessment. As already demonstrated herein, Section 1851 of the California Unemployment Insurance Code and Article XIII, Section 32 of the California Constitution prohibit all such court relief. It should be further noted that federal courts have recognized that there is a distinction, for purposes of Section 1341, between an unconstitutional tax and an unconstitutional tax procedure. As the Seventh Circuit has stated:

> "In the instant case, we have no claim of the denial of procedural due process. Plaintiffs do not complain of the method of assessing or collecting the tax. They complain of the tax itself." *Gray v. Morgan*, 371 F. 2d 172, 175 (7th Cir. 1966) *cert. den.* 386 U. S. 1033.

And see also *Garrett v. Bamford*, 536 F. 2d 63 (3d Cir. 1976), *cert. den.* 429 U. S. 977 (1976). Thus, where the procedure itself may violate constitutional liberties, the tax protester ought not to be forced into that procedure, irrespective of considerations of administrative convenience.

While churches and teachers, who must pay unemployment insurance as a prerequisite to petitioning for reassessment or refund under California law, at least have some avenue to eventual blocking of further taxation, the

pastors and parents who are appellees in this matter have no authorized means of protecting their religious liberty in any manner at all under California law since they do not actually pay the tax.

Therefore, it cannot be said that any of the appellees herein, be they churches, pastors, parents or teachers, are provided a "plain, speedy, and efficient remedy" in the courts of California to prevent the loss of their religious freedoms at the hands of government agencies.

The district court, on well established grounds, was thus correct in holding that the Tax Injunction Act did not deprive the court of jurisdiction.

2. Imposition of the Unemployment Tax Act Upon the Appellee Non-Church-Operated Schools Violates Liberties of Those Schools, Their Staffs and Patrons Protected by the Religion Clauses of the First Amendment.

The appellee Redwood Christian Schools consists of schools which are precisely the same in religious character as the schools of the churches which are appellees herein, except for the fact that they are not operated by a particular denominational church. The district court, based on the evidence presented, found:

> "The church-affiliated and non-church affiliated schools in the two cases are virtually indistinguishable in religious mission. The overriding purpose of all the schools is to instill religious values and beliefs in young people. In each school, an attempt is made to create an environment in which religion is pervasive. An effort is made to teach all subjects, including those traditionally regarded as secular, from a religious perspective, and religion permeates extra-curricular activities as well." App. E, 75a.

The court held, therefore, that the non-church religious schools are entitled to the same First Amendment protection against imposition of the Unemployment Tax Act as the church-schools. The conclusion of the court is patently correct, and the Government, in its Jurisdictional Statement, does not deny that conclusion. Without insistence on its point, however, and discussing the matter only in an inconclusive footnote, the Jurisdictional Statement[5] hazards that the pervasively religious Redwood Christian Schools ought to be treated as though they were secular. The Government says that church-run schools "are more likely" to be strongly religious than schools of the Redwood type. "Likely" has nothing to do with the matter: the trial court's findings of fact *establish* that Redwood Christian Schools are just as intensively religious as the church-schools. The Government next says (without more) that the "risk" of church political entanglement is greater when church-schools are involved. That is merely guesswork; political entanglement appears confined to situations where religious groups (not necessarily church) seek public subsidy. *Lemon, supra,* at 622-623. Third, the Government says there is "greater likelihood" that employees of church-schools will be provided with non-governmental assistance for hardship due to unemployment. This, again, is simply speculation, and the record below shows that it is a matter of religious principle with Redwood Christian Schools that they accept no governmental assistance. T. 44-45.[6] Finally, the Government argues that it "may be" very difficult to determine whether a non-church school is "religious", as compared with a church-school. Again, the record here speaks for

5. Fn. 15 at Page 16.

6. References are to the transcript of proceedings before the Hon. Mariana R. Pfaelzer on August 12-13, 1980.

itself and the court below made clear findings that the Redwood Christian Schools *are* exclusively and pervasively religious. Jurisdictional Statement, App. E, 75a.

Mainly, the Government directs the Court's attention to two points. Each of these being without substance, it is clear that briefing and oral argument on them is not called for.

First: the Government states that there "may be" some conceptual confusion in the district court's reliance on the Establishment Clause. Jurisdictional Statement, 11. The Government's suggestion is completely off track. It is of no significance that cases cited by the Government such as *Lemon v. Kurtzman, supra*, involved aid to religious institutions. The Court, in those cases, did not condemn the entanglements because they were aid, but the aid because it was entangling. See *Catholic Bishop of Chicago*, 440 U. S. at 501. Further, even if Redwood Christian Schools' claim were to be read as principally challenging a governmental inhibiting of religion, where the primary effect of the challenged enactment is "the inhibition of religion" the Establishment Clause has been held applicable. *Abington School District v. Schempp*, 374 U. S. 203, 232 (1963). But having essayed this, the Government drops the point and moves on to discuss the Establishment Clause holding below.

Second: it is clear that, as to both the church-schools and the non-church religious schools, the benefit eligibility determination process involves not only actual excessive entanglements but also the potential for excessive entanglements (the latter, too, being forbidden by the Establishment Clause. *Public Funds for Public Schools v. Marburger*, 358 F. Supp. 29 (D. N. J. 1973), *aff'd.*, 417 U. S. 961 (1974).

The Government argues: (1) that the evidence produced at trial does not support the district court's finding

of excessive entanglements arising from the benefit eligibility determination process. Jurisdictional Statement, 16; (2) that no excessive entanglements are necessitated in the statutory benefit eligibility determination process because whether an employee was discharged for misconduct would depend simply upon whether he or she knowingly failed to abide by an established "work rule". *Id.* at 14-15.

1. The Government is tardy in attempting to improve, from its point of view, the trial record. The unemployment compensation program is a federally controlled program.[7] Upon the trial the federal government presented expert testimony as to how determinations are made where the employee of a religious school is discharged on religious or moral grounds. T. 232-282. The district court most justifiably relied upon the federal experts' testimony. App. E, 67a-70a. But it based its conclusion respecting entanglement *also* upon what is regarded as the "*inevitable*" effect of the operation of the statute. *Id.* at 71a. So far, therefore, as the Government complains that the record evidence does not support the district court's conclusion, it raises a matter of no substance whatsoever.

2. The Government also argues that no excessive entanglements are necessitated in the statutory benefit eli-

7. The United States Secretary of Labor is required to approve the law of any state participating in it, 26 U. S. C. § 3304(a), and each year he must certify to the Secretary of the Treasury each state whose law he has previously approved (26 U. S. C. § 3304(c)), and can decertify any state which has failed to comply with certification requirements. 26 U. S. C. § 3304(c), (d). Credit against the federal tax imposed by the Federal Unemployment Tax Act, for contributions made to state unemployment compensation funds, is dependent upon the aforementioned federal certification. 26 U. S. C. § 3302(a).

gibility determination process because whether an employee was discharged for misconduct would depend simply upon whether he or she knowingly failed to abide by an "established work rule" (which would incorporate religious requirements). The inquiry in such case would apparently be purely secular (What was the "work rule" and was it knowingly violated?).

The Government's attempt to reduce to a "work rule" the requirements of religious faith (in the setting of an employment of a religious ministry) calls for a vast oversimplification of the factors involved.[8] The district court pointed to the two prime defects of this approach:

> "First, it underestimates the complexity of religious faith. In effect, the Secretary's approach requires

8. In footnote 5 of its Jurisdictional Statement at Page 17, the State of California, in its appeal from the decision below *Grace Brethren Church, et al. v. State of California, et al.* (No. 81-31), points to Title 22 of the California Administrative Code, Section 1256-36(b)(1), which lists a series of situations in which an employee is *not* required to comply with a "work rule" regardless of its terms. The prospect of these situations but broadens the vista of unconstitutional entanglements necessarily presented by the application of the statute to religious ministries. For example, under Situation 2, in the footnote, the employee's non-compliance with the "work rule" would be based on its imposing "a new and unreasonable burden upon the employee." If that burden consisted of a religious duty, the state would determine whether that religious duty was an "unreasonable" burden. Similar potential entanglements are found in Situations 3, 5 and 6. In the hope of avoiding the entanglement issue, the appellants are careful to state that "the context in which an employee is not required to comply with a work rule under the above regulation is determined solely according to secular standards." This makes the effect even worse constitutionally: if the religious ministry insists that the "work rule" is not unreasonable because it is religiously required, the state may not hear of that: it must apply solely "secular standards"—thus effectively wiping out the religious claim.

religious schools wishing to make adherence to religious doctrine a condition of employment to develop and explain to prospective employees detailed, all-encompassing articles of religious belief. Such a task could never be accomplished. It should be obvious that not all doctrinally-based 'implied work rules' can be prescribed in advance; nor can religious ideals like 'fervor,' which may be satisfied or breached by infinitely varied patterns of conduct, be precisely defined.

"Second, the adoption of a rule making the employee's subjective understanding of his employment terms decisive would embroil the hearing examiner in credibility questions which can only be resolved by involvement in religious issues. For example, the fundamentalist school principal confronted with a claim by a teacher fired for advocacy of a particular doctrine or practice that his understanding of fundamentalist doctrine did not require opposition to that doctrine or practice might well wish to challenge the credibility of the teacher's assertion by establishing that such opposition *really* is mandated by fundamentalist doctrine and that alleged ignorance of that fact *must* be feigned. Similarly, a teacher fired ostensibly for religious reasons might wish to show that the religious reasons advanced for the discharge were a pretext by showing that the reasons asserted were not an accurate statement of the tenets of fundamentalist faith. In short, there are so many ways in which doctrinal questions could become material to benefit eligibility determinations that decisions on religious issues by secular administrators is, in this Court's opinion, inevitable if fundamentalist schools typified by some of the plaintiffs in the Grace Breth-

> ren case are subjected to the benefit determination process." App. E, 70a-71a.

To be noted here is the warning of the Supreme Court respecting the right of religious bodies to "establish their own rules and regulations for internal discipline and government . . ." *Serbian Eastern Orthodox Diocese v. Milivojevich*, 426 U. S. 696, 724 (1976).

The district court's conclusion, that the benefit eligibility determination process inevitably involves secular officials in religious disputes and thus "runs afoul of the constitutional prohibition against excessive entanglement between the state and religion", is the most obvious of conclusions arising out of the now settled principles laid down in this Court's decisions on church-state separation (*e.g.*, *Walz v. Tax Commission*, 397 U. S. 664 (1970); *Lemon v. Kurtzman*, *supra*; *Serbian Eastern Orthodox Diocese v. Milivojevich*, *supra*). No further review of the district court's decision is conceivably warranted.

CONCLUSION

Wherefore, appellees respectfully submit that the questions presented by appellants are so unsubstantial as not to require further argument, and appellees respectfully move the Court to affirm the judgment entered in this case by the district court.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 79-3763
DC# CV 79-0093
MRPfaelzer
C. Cal.

GRACE BRETHREN CHURCH, etc., et al.,
Plaintiffs/Appellees,

v.

STATE OF CALIFORNIA, etc., et al.,
Defendants/Appellants

No. 79-3764
DC# CV 79-0162
MRPfaelzer
C. Cal.

THE LUTHERAN CHURCH—MISSOURI SYNOD, etc., et al.,
Plaintiffs/Appellees,

v.

THE STATE OF CALIFORNIA EMPLOYMENT DEVELOPMENT DEPARTMENT, etc., et al.,
Defendants/Appellants.

Order of Dismissal

Having considered the Stipulation for Dismissal filed by the parties hereby pursuant to Rule 42(b), Federal Rules of Civil Procedure, the Court hereby dismisses the instant appeal.

The parties are to bear their own costs.

DATED: This 24th day of JULY, 1980.

/s/ KATHRYN D. FREEMAN
Deputy Clerk

For: RICHARD H. DEANE,
Clerk of Court